

SECURITIES FRAUD DETERRENCE AND INVESTOR  
RESTITUTION ACT OF 2004

APRIL 27, 2004.—Ordered to be printed

Mr. OXLEY, from the Committee on Financial Services,  
submitted the following

R E P O R T

together with

DISSENTING VIEWS

[To accompany H.R. 2179]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 2179) to enhance the authority of the Securities and Exchange Commission to investigate, punish, and deter securities laws violations, and to improve its ability to return funds to defrauded investors, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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## AMENDMENT

The amendment is as follows:

Strike all after the enacting clause and insert the following:

### SECTION 1. SHORT TITLE.

This Act may be cited as the “Securities Fraud Deterrence and Investor Restitution Act of 2004”.

### SEC. 2. RECOVERY BY COMMISSION OF SECURITIES LAW JUDGMENTS.

(a) AMENDMENT.—Title III of the Sarbanes-Oxley Act of 2002 is amended by adding after section 308 (15 U.S.C. 7246) the following new section:

#### “SEC. 309. RECOVERY OF SECURITIES LAW JUDGMENTS; REMOVAL OF STATE LAW IMPEDIMENTS.

“(a) REMOVAL OF STATE LAW IMPEDIMENTS.—The Commission’s authority to enforce, collect upon, or otherwise satisfy in a Federal or State court a judgment or order obtained, either by litigation or settlement, in any judicial action or administrative proceeding under the securities laws against any person based upon an alleged fraudulent, deceptive, or manipulative act or practice in violation of such laws, or the rules and regulations thereunder, or against any gratuitous or fraudulent transferee, shall not be subject to—

“(1) a debtor’s election to exempt property under State or local law pursuant to section 3014(a)(2) of title 28, United States Code; or

“(2) any homestead provision of any State constitution or any other State law that exempts or protects property from foreclosure, forced sale, or any other procedure to satisfy a judgment or order under any process of court for the payment of debts.

“(b) DEFINITIONS.—For purposes of subsection (a)—

“(1) a ‘gratuitous transferee’ is any person to whom an ownership interest in property is transferred without adequate consideration; and

“(2) a ‘fraudulent transferee’ is any person liable to the Commission under applicable fraudulent transfer laws.”.

(b) CONFORMING AMENDMENT.—The table of contents in section 1(b) of the Sarbanes-Oxley Act of 2002 is amended by inserting after the item relating to section 308 the following:

“Sec. 309. Recovery of securities law judgments; removal of state law impediments.”.

### SEC. 3. CIVIL ENFORCEMENT PROVISIONS.

(a) AUTHORITY TO IMPOSE CIVIL PENALTIES IN CEASE AND DESIST PROCEEDINGS.—

(1) UNDER THE SECURITIES ACT OF 1934.—Section 8A of the Securities Act of 1933 (15 U.S.C. 77h–1) is amended by adding at the end the following new subsection:

“(g) AUTHORITY TO IMPOSE MONEY PENALTIES.—

“(1) GROUNDS FOR IMPOSING.—In any cease-and-desist proceeding under subsection (a), the Commission may impose a civil penalty on a person if it finds, on the record after notice and opportunity for hearing, that—

“(A) such person—

“(i) is violating or has violated any provision of this title, or any rule or regulation thereunder; or

“(ii) is or was a cause of the violation of any provision of this title, or any rule or regulation thereunder; and

“(B) such penalty is in the public interest.

“(2) MAXIMUM AMOUNT OF PENALTY.—

“(A) FIRST TIER.—The maximum amount of penalty for each act or omission described in paragraph (1) shall be \$100,000 for a natural person or \$250,000 for any other person.

“(B) SECOND TIER.—Notwithstanding paragraph (A), the maximum amount of penalty for each such act or omission shall be \$500,000 for a natural person or \$1,000,000 for any other person if the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

“(C) THIRD TIER.—Notwithstanding paragraphs (A) and (B), the maximum amount of penalty for each such act or omission shall be \$1,000,000 for a natural person or \$2,000,000 for any other person if—

“(i) the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and

“(ii) such act or omission directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission.

“(3) EVIDENCE CONCERNING ABILITY TO PAY.—In any proceeding in which the Commission may impose a penalty under this section, a respondent may present evidence of the respondent’s ability to pay such penalty. The Commission may, in its discretion, consider such evidence in determining whether such penalty is in the public interest. Such evidence may relate to the extent of such person’s ability to continue in business and the collectability of a penalty, taking into account any other claims of the United States or third parties upon such person’s assets and the amount of such person’s assets.”.

(2) UNDER THE SECURITIES EXCHANGE ACT OF 1934.—Subsection (a) of section 21B of the Securities Exchange Act of 1934 (15 U.S.C. 78u-2(a)) is amended—

(A) by striking “(a) COMMISSION AUTHORITY TO ASSESS MONEY PENALTIES.—In any proceeding” and inserting the following:

“(a) COMMISSION AUTHORITY TO ASSESS MONEY PENALTIES.—

“(1) IN GENERAL.—In any proceeding”;

(B) by redesignating paragraphs (1) through (4) of such subsection as subparagraphs (A) through (D), respectively and moving such redesignated subparagraphs and the matter following such subparagraphs 2 ems to the right; and

(C) by adding at the end of such subsection the following new paragraph:

“(2) CEASE-AND-DESIST PROCEEDINGS.—In any proceeding instituted pursuant to section 21C of this title against any person, the Commission may impose a civil penalty if it finds, on the record after notice and opportunity for hearing, that such person—

“(A) is violating or has violated any provision of this title, or any rule or regulation thereunder; or

“(B) is or was a cause of the violation of any provision of this title, or any rule or regulation thereunder.”.

(3) UNDER THE INVESTMENT COMPANY ACT OF 1940.—Paragraph (1) of section 9(d) of the Investment Company Act of 1940 (15 U.S.C. 80a-9(d)(1)) is amended—

(A) by striking “(1) AUTHORITY OF COMMISSION.—In any proceeding” and inserting the following:

“(1) AUTHORITY OF COMMISSION.—

“(A) IN GENERAL.—In any proceeding”;

(B) by redesignating subparagraphs (A) through (C) of such paragraph as clauses (i) through (iii), respectively and by moving such redesignated clauses and the matter following such subparagraphs 2 ems to the right; and

(C) by adding at the end of such paragraph the following new subparagraph:

“(B) CEASE-AND-DESIST PROCEEDINGS.—In any proceeding instituted pursuant to subsection (f) against any person, the Commission may impose a civil penalty if it finds, on the record after notice and opportunity for hearing, that such person—

“(i) is violating or has violated any provision of this title, or any rule or regulation thereunder; or

“(ii) is or was a cause of the violation of any provision of this title, or any rule or regulation thereunder.”.

(4) UNDER THE INVESTMENT ADVISERS ACT OF 1940.—Paragraph (1) of section 203(i) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(i)(1)) is amended—

(A) by striking “(1) AUTHORITY OF COMMISSION.—In any proceeding” and inserting the following:

“(1) AUTHORITY OF COMMISSION.—

“(A) IN GENERAL.—In any proceeding”;

(B) by redesignating subparagraphs (A) through (D) of such paragraph as clauses (i) through (iv), respectively and moving such redesignated clauses and the matter following such subparagraphs 2 ems to the right; and

(C) by adding at the end of such paragraph the following new subparagraph:

“(B) CEASE-AND-DESIST PROCEEDINGS.—In any proceeding instituted pursuant to subsection (k) against any person, the Commission may impose a

civil penalty if it finds, on the record after notice and opportunity for hearing, that such person—

- “(i) is violating or has violated any provision of this title, or any rule or regulation thereunder; or
  - “(ii) is or was a cause of the violation of any provision of this title, or any rule or regulation thereunder.”.
- (b) INCREASED MAXIMUM CIVIL MONEY PENALTIES.—
- (1) SECURITIES ACT OF 1933.—Section 20(d)(2) of the Securities Act of 1933 (15 U.S.C. 77t(d)(2)) is amended—
- (A) in subparagraph (A)(i)—
    - (i) by striking “\$5,000” and inserting “\$100,000”; and
    - (ii) by striking “\$50,000” and inserting “\$250,000”;
  - (B) in subparagraph (B)(i)—
    - (i) by striking “\$50,000” and inserting “\$500,000”; and
    - (ii) by striking “\$250,000” and inserting “\$1,000,000”; and
  - (C) in subparagraph (C)(i)—
    - (i) by striking “\$100,000” and inserting “\$1,000,000”; and
    - (ii) by striking “\$500,000” and inserting “\$2,000,000”.
- (2) SECURITIES EXCHANGE ACT OF 1934.—
- (A) PENALTIES.—Section 32 of the Securities Exchange Act of 1934 (15 U.S.C. 78ff) is amended—
- (i) in subsection (b), by striking “\$100” and inserting “\$10,000”; and
  - (ii) in subsection (c)—
    - (I) in paragraph (1)(B), by striking “\$10,000” and inserting “\$500,000”; and
    - (II) in paragraph (2)(B), by striking “\$10,000” and inserting “\$500,000”.
  - (B) INSIDER TRADING.—Section 21A(a)(3) of the Securities Exchange Act of 1934 (15 U.S.C. 78u-1(a)(3)) is amended by striking “\$1,000,000” and inserting “\$2,000,000”.
  - (C) ADMINISTRATIVE PROCEEDINGS.—Section 21B(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78u-2(b)) is amended—
    - (i) in paragraph (1)—
      - (I) by striking “\$5,000” and inserting “\$100,000”; and
      - (II) by striking “\$50,000” and inserting “\$250,000”;
    - (ii) in paragraph (2)—
      - (I) by striking “\$50,000” and inserting “\$500,000”; and
      - (II) by striking “\$250,000” and inserting “\$1,000,000”; and
    - (iii) in paragraph (3)—
      - (I) by striking “\$100,000” and inserting “\$1,000,000”; and
      - (II) by striking “\$500,000” and inserting “\$2,000,000”.
  - (D) CIVIL ACTIONS.—Section 21(d)(3)(B) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)(3)(B)) is amended—
    - (i) in clause (i)(I)—
      - (I) by striking “\$5,000” and inserting “\$100,000”; and
      - (II) by striking “\$50,000” and inserting “\$250,000”;
    - (ii) in clause (ii)(I)—
      - (I) by striking “\$50,000” and inserting “\$500,000”; and
      - (II) by striking “\$250,000” and inserting “\$1,000,000”; and
    - (iii) in clause (iii)(I)—
      - (I) by striking “\$100,000” and inserting “\$1,000,000”; and
      - (II) by striking “\$500,000” and inserting “\$2,000,000”.
- (3) INVESTMENT COMPANY ACT OF 1940.—
- (A) INELIGIBILITY.—Section 9(d)(2) of the Investment Company Act of 1940 (15 U.S.C. 80a-9(d)(2)) is amended—
- (i) in subparagraph (A)—
    - (I) by striking “\$5,000” and inserting “\$100,000”; and
    - (II) by striking “\$50,000” and inserting “\$250,000”;
  - (ii) in subparagraph (B)—
    - (I) by striking “\$50,000” and inserting “\$500,000”; and
    - (II) by striking “\$250,000” and inserting “\$1,000,000”; and
  - (iii) in subparagraph (C)—
    - (I) by striking “\$100,000” and inserting “\$1,000,000”; and
    - (II) by striking “\$500,000” and inserting “\$2,000,000”.
- (B) ENFORCEMENT OF INVESTMENT COMPANY ACT.—Section 42(e)(2) of the Investment Company Act of 1940 (15 U.S.C. 80a-41(e)(2)) is amended—
- (i) in subparagraph (A)(i)—
    - (I) by striking “\$5,000” and inserting “\$100,000”; and
    - (II) by striking “\$50,000” and inserting “\$250,000”;

- (ii) in subparagraph (B)(i)—
    - (I) by striking “\$50,000” and inserting “\$500,000”; and
    - (II) by striking “\$250,000” and inserting “\$1,000,000”; and
  - (iii) in subparagraph (C)(i)—
    - (I) by striking “\$100,000” and inserting “\$1,000,000”; and
    - (II) by striking “\$500,000” and inserting “\$2,000,000”.
- (4) INVESTMENT ADVISERS ACT OF 1940.—
- (A) REGISTRATION.—Section 203(i)(2) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(i)(2)) is amended—
- (i) in subparagraph (A)—
    - (I) by striking “\$5,000” and inserting “\$100,000”; and
    - (II) by striking “\$50,000” and inserting “\$250,000”;
  - (ii) in subparagraph (B)—
    - (I) by striking “\$50,000” and inserting “\$500,000”; and
    - (II) by striking “\$250,000” and inserting “\$1,000,000”; and
  - (iii) in subparagraph (C)—
    - (I) by striking “\$100,000” and inserting “\$1,000,000”; and
    - (II) by striking “\$500,000” and inserting “\$2,000,000”.
- (B) ENFORCEMENT OF INVESTMENT ADVISERS ACT.—Section 209(e)(2) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-9(e)(2)) is amended—
- (i) in subparagraph (A)(i)—
    - (I) by striking “\$5,000” and inserting “\$100,000”; and
    - (II) by striking “\$50,000” and inserting “\$250,000”;
  - (ii) in subparagraph (B)(i)—
    - (I) by striking “\$50,000” and inserting “\$500,000”; and
    - (II) by striking “\$250,000” and inserting “\$1,000,000”; and
  - (iii) in subparagraph (C)(i)—
    - (I) by striking “\$100,000” and inserting “\$1,000,000”; and
    - (II) by striking “\$500,000” and inserting “\$2,000,000”.
- (c) AUTHORITY TO OBTAIN FINANCIAL RECORDS.—Section 21(h) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(h)) is amended—
- (1) by striking paragraphs (2) through (8);
  - (2) in paragraph (9), by striking “(9)(A)” and all that follows through “(B) The” and inserting “(3) The”;
  - (3) by inserting after paragraph (1), the following:
    - “(2) ACCESS TO FINANCIAL RECORDS.—
    - “(A) IN GENERAL.—Notwithstanding section 1105 or 1107 of the Right to Financial Privacy Act of 1978, the Commission may obtain access to and copies of, or the information contained in, financial records of any person held by a financial institution, including the financial records of a customer, without notice to that person, when it acts pursuant to a subpoena authorized by a formal order of investigation of the Commission and issued under the securities laws or pursuant to an administrative or judicial subpoena issued in a proceeding or action to enforce the securities laws.
    - “(B) NONDISCLOSURE OF REQUESTS.—If the Commission so directs in its subpoena, no financial institution, or officer, director, partner, employee, shareholder, representative or agent of such financial institution, shall, directly or indirectly, disclose that records have been requested or provided in accordance with subparagraph (A), if the Commission finds reason to believe that such disclosure may—
    - “(i) result in the transfer of assets or records outside the territorial limits of the United States;
    - “(ii) result in improper conversion of investor assets;
    - “(iii) impede the ability of the Commission to identify, trace, or freeze funds involved in any securities transaction;
    - “(iv) endanger the life or physical safety of an individual;
    - “(v) result in flight from prosecution;
    - “(vi) result in destruction of or tampering with evidence;
    - “(vii) result in intimidation of potential witnesses; or
    - “(viii) otherwise seriously jeopardize an investigation or unduly delay a trial.
    - “(C) TRANSFER OF RECORDS TO GOVERNMENT AUTHORITIES.—The Commission may transfer financial records or the information contained therein to any government authority, if the Commission proceeds as a transferring agency in accordance with section 1112 of the Right to Financial Privacy Act of 1978 (12 U.S.C. 3412), except that a customer notice shall not be required under subsection (b) or (c) of that section 1112, if the Commission determines that there is reason to believe that such notification may result

in or lead to any of the factors identified under clauses (i) through (viii) of subparagraph (B) of this paragraph.”;

(4) by striking paragraph (10); and

(5) by redesignating paragraphs (11), (12), and (13) as paragraphs (4), (5), and (6), respectively.

**SEC. 4. AUTHORITY TO ACCEPT PRIVILEGED AND PROTECTED INFORMATION.**

Section 24 of the Securities Exchange Act of 1934 (15 U.S.C. 78x) is amended—

(1) by redesignating subsection (e) as subsection (f); and

(2) by inserting after subsection (d) the following new subsection:

“(e) AUTHORITY TO ACCEPT PRIVILEGED AND PROTECTED INFORMATION.—

“(1) AUTHORITY.—Notwithstanding any other provision of law, whenever the Commission or an appropriate regulatory agency and any person agree in writing to terms pursuant to which such person will produce or disclose to the Commission or the appropriate regulatory agency any document or information that is subject to any Federal or State law privilege, or to the protection provided by the work product doctrine, such production or disclosure shall not constitute a waiver of the privilege or protection as to any person other than the Commission or the appropriate regulatory agency to which the document or information is provided.

“(2) DEFINITION.—For purposes of this subsection, the term ‘appropriate regulatory agency’ means the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, or the Board of Governors of the Federal Reserve System.”.

**SEC. 5. ACCESS TO GRAND JURY INFORMATION.**

(a) AMENDMENT.—Title VI of the Sarbanes-Oxley Act of 2002 is amended by adding at the end thereof the following new section:

**“SEC. 605. ACCESS TO GRAND JURY INFORMATION.**

“(a) DISCLOSURE OF CERTAIN MATTERS OCCURRING BEFORE GRAND JURY FOR USE IN ENFORCING SECURITIES LAWS.—

“(1) IN GENERAL.—Upon motion of an attorney for the government, a court may direct disclosure of matters occurring before a grand jury during an investigation of conduct that may constitute a violation of any provision of the securities laws to identified personnel of the Commission for use in relation to any matter within the jurisdiction of the Commission.

“(2) FINDING OF SUBSTANTIAL NEED REQUIRED.—A court may issue an order under paragraph (1) only upon a finding of a substantial need in the public interest.

“(b) RESTRICTED USE OF INFORMATION.—A person to whom a matter has been disclosed under this section shall not use such matter other than for the purpose for which such disclosure was authorized.

“(c) DEFINITIONS.—As used in this section, the terms ‘attorney for the government’ and ‘grand jury information’ have the meanings given to those terms in section 3322 of title 18, United States Code.”.

(b) CONFORMING AMENDMENT.—The table of contents in section 1(b) of the Sarbanes-Oxley Act of 2002 is amended by inserting after the item relating to section 604 the following:

“Sec. 605. Access to grand jury information.”.

**SEC. 6. NATIONWIDE SERVICE OF PROCESS.**

(a) SECURITIES ACT OF 1933.—Section 22(a) of the Securities Act of 1933 (15 U.S.C. 77v(a)) is amended by inserting after the second sentence the following: “In any action or proceeding instituted by the Commission under this title in a United States district court for any judicial district, subpoenas issued by or on behalf of such court to compel the attendance of witnesses or the production of documents or tangible things (or both) may be served in any other district. Such subpoenas may be served and enforced without application to the court or a showing of cause, notwithstanding the provisions of rule 45(b)(2), (c)(3)(A)(ii), and (c)(3)(B)(iii) of the Federal Rules of Civil Procedure.”.

(b) SECURITIES EXCHANGE ACT OF 1934.—Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. 78aa) is amended by inserting after the second sentence the following: “In any action or proceeding instituted by the Commission under this title in a United States district court for any judicial district, subpoenas issued by or on behalf of such court to compel the attendance of witnesses or the production of documents or tangible things (or both) may be served in any other district. Such subpoenas may be served and enforced without application to the court or a showing of cause, notwithstanding the provisions of rule 45(b)(2), (c)(3)(A)(ii), and (c)(3)(B)(iii) of the Federal Rules of Civil Procedure.”.

(c) INVESTMENT COMPANY ACT OF 1940.—Section 44 of the Investment Company Act of 1940 (15 U.S.C. 80a-43) is amended by inserting after the fourth sentence the following: “In any action or proceeding instituted by the Commission under this title in a United States district court for any judicial district, subpoenas issued by or on behalf of such court to compel the attendance of witnesses or the production of documents or tangible things (or both) may be served in any other district. Such subpoenas may be served and enforced without application to the court or a showing of cause, notwithstanding the provisions of rule 45(b)(2), (c)(3)(A)(ii), and (c)(3)(B)(iii) of the Federal Rules of Civil Procedure.”.

(d) INVESTMENT ADVISERS ACT OF 1940.—Section 214 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-14) is amended by inserting after the third sentence the following: “In any action or proceeding instituted by the Commission under this title in a United States district court for any judicial district, subpoenas issued by or on behalf of such court to compel the attendance of witnesses or the production of documents or tangible things (or both) may be served in any other district. Such subpoenas may be served and enforced without application to the court or a showing of cause, notwithstanding the provisions of rule 45(b)(2), (c)(3)(A)(ii), and (c)(3)(B)(iii) of the Federal Rules of Civil Procedure.”.

**SEC. 7. AUTHORITY TO CONTRACT WITH PRIVATE COUNSEL FOR LEGAL SERVICES TO COLLECT DELINQUENT JUDGMENTS AND ORDERS.**

Subsection (b) of section 4 of the Securities Exchange Act of 1934 (15 U.S.C. 78d(b)) is amended—

(1) in the subsection heading by striking “AND LEASING AUTHORITY.—” and inserting “, LEASING AUTHORITY, AND CONTRACTING AUTHORITY.—”; and

(2) by adding at the end of such subsection the following new paragraph:

“(4) CONTRACTING AUTHORITY.—

“(A) IN GENERAL.—Notwithstanding any other provision of law, the Commission is authorized to enter into contracts to retain private legal counsel to furnish legal services, including representation in litigation, negotiation, compromise, and settlement, in the case of any claim of indebtedness resulting from any judgment or order (either by litigation or settlement) obtained by the Commission in any judicial action or administrative proceeding brought by or on behalf of the Commission. Private counsel retained under this paragraph may represent the Commission in such debt collection matters to the same extent as the Commission may represent itself.

“(B) TERMS AND CONDITIONS OF CONTRACT.—Each such contract shall include such terms and conditions as the Commission considers necessary and appropriate, and shall include provisions specifying—

“(i) the amount of the fee to be paid to the private counsel under such contract or the method for calculating that fee;

“(ii) that the Commission retains the authority to represent itself, resolve a dispute, compromise a claim, end collection efforts, and refer a matter to other private counsel or to the Attorney General; and

“(iii) that the Commission may terminate either the contract or the private counsel’s representation of the Commission in particular cases for any reason, including for the convenience of the Commission.

“(C) PAYMENT OF FEES.—Notwithstanding section 3302(b) of title 31, United States Code, a contract under this paragraph may provide that fees and costs incurred by private counsel under such contracts are payable from the amounts recovered.

“(D) COMPETITION REQUIREMENTS.—Nothing in this paragraph shall relieve the Commission of the competition requirements set forth in title III of the Federal Property and Administrative Services Act of 1949 (41 U.S.C. 251 et seq.).

“(E) COUNTERCLAIMS.—In any action to recover indebtedness which is brought on behalf of the Commission by private counsel retained under this paragraph, no counterclaim may be asserted against the Commission unless the counterclaim is served directly on the Commission. Such service shall be made in accordance with the rules of procedure of the court in which the action is brought.”.

**SEC. 8. FAIR ACT AMENDMENTS.**

(a) CIVIL PENALTIES.—Section 308(a) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7246(a)) is amended to read as follows:

“(a) CIVIL PENALTIES TO BE USED FOR THE RELIEF OF VICTIMS.—If in any judicial or administrative action brought by the Commission under the securities laws (as such term is defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47))) the Commission obtains pursuant to such laws a civil penalty

against any person, such civil penalty monies shall, on the motion or at the direction of the Commission, be added to and become part of a fund for the benefit of the victims of such violation.”.

(b) **STUDY ON FEDERAL AND STATE SECURITIES COORDINATION, COOPERATION, AND COMMUNICATION.**—

(1) **STUDY.**—The Securities and Exchange Commission shall seek to produce a joint study in cooperation with an association of duly constituted representatives of State governments whose primary assignment is the regulation of the securities business within those States, on improved coordination, cooperation and communication between the Commission and State securities regulators.

(2) **SUBJECT OF STUDY.**—If the association referred to in paragraph (1) agrees to participate in such a study, the study shall be prepared jointly by the Commission and the association, and shall be based on an initiative announced September 14, 2003, between the Commission and the association aimed at improving coordination, cooperation, and communication between the Commission and State securities regulators.

(3) **REPORT.**—If the association referred to in paragraph (1) agrees to participate in such a study, the results of the study shall be jointly reported to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate by September 14, 2005, or 1 year after the date of enactment of this Act, whichever is later.

(c) **ADDITIONAL PROVISIONS.**—Section 308 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7246) is further amended—

(1) by redesignating subsections (c), (d), and (e) as subsections (e), (f), and (g), respectively; and

(2) by inserting the following after subsection (b):

“(c) **USE OF INVESTOR RESTITUTION FUND BY STATES.**—The Commission may allow a State that has received penalty or disgorgement payments pursuant to an agreement or settlement with a broker or dealer or other party in an action concerning securities fraud to contribute those payments to a fund administered by the Commission for the purpose of making restitution payments to investors, whether or not the Commission was a party to the agreement or settlement or had established such fund prior to the State’s contribution. The Commission shall have the authority otherwise available to it under the securities laws with respect to the administration and distribution of such funds.

“(d) **UNDISTRIBUTED FUNDS TO BE USED FOR INVESTOR EDUCATION.**—In any judicial or administrative action in which a fund is created pursuant to subsection (a) or in which the Commission had obtained disgorgement, if the Commission determines (due to the size of the fund to be distributed, the number of investors, the nature of the underlying violation, or for other reasons) that it would be infeasible to distribute such fund or disgorgement to the victims of the violation, or if after distribution of the fund or disgorgement to victims there are excess monies remaining, the Commission may move for an order in a judicial action, or may issue an order in an administrative proceeding, requiring that the undistributed amount of the fund or disgorgement be used for investor education programs administered by an established not-for-profit or governmental organization whose purposes include investor education and financial literacy.”.

**SEC. 9. REDUCTION OF EXCESSIVE DISTRIBUTION AND MARKETING FEES.**

Within 90 days after the date of enactment of this Act, the Securities and Exchange Commission shall, by rule or regulation under the Investment Company Act of 1940, prohibit as unreasonable or deceptive any fee by a registered open-end investment company under a plan adopted pursuant to rule 12b-1 of the Commission’s rules (17 CFR 270.12b-1) that continues to include any charges for expenses for any activity after such company has been closed to new investors, other than shareholder servicing activities the costs of which are collected directly and transparently from the investor.

**SEC. 10. DISCLOSURE RESPONSIBILITIES AT CONTRACT RENEWAL.**

Subsection (c) of section 15 of the Investment Company Act of 1940 (15 U.S.C. 80a-15(c)) is amended to read as follows:

“(c) **PROCESS FOR CONTRACT RENEWAL.**—

“(1) **APPROVAL BY MAJORITY OF INDEPENDENT DIRECTORS.**—In addition to the requirements of subsections (a) and (b) of this section, it shall be unlawful for any registered investment company having a board of directors to enter into, renew, or perform any contract or agreement, written or oral, whereby a person undertakes regularly to serve or act as investment adviser of or principal underwriter for such company, unless the terms of such contract or agreement and any renewal thereof have been approved by the vote of a majority of directors, who are not parties to such contract or agreement or interested persons of any

such party, cast in person at a meeting called for the purpose of voting on such approval.

**(2) INFORMATION DISCLOSURES AND EVALUATIONS.—**

**“(A) IN GENERAL.—**It shall be the duty of the directors of a registered investment company to request and evaluate, and the duty of an investment adviser or principal underwriter of such company to furnish, such information as may reasonably be necessary to evaluate the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser or principal underwriter of such company.

**“(B) INVESTMENT ADVISER DUTY.—**In addition to the investment adviser’s duty under subparagraph (A), when entering into or renewing a contract or agreement, it shall be the duty of the investment adviser—

“(i) to provide the independent directors of a registered investment company with all material information about any of its business practices, or the business practices of any of its affiliated persons, that may conflict with the best interests of the shareholders of the registered investment company; and

“(ii) to specify and commit to implement procedures that are reasonably designed to ensure services are provided in the best interests of such shareholders.

**“(C) PRINCIPAL UNDERWRITER DUTY.—**In addition to the principal underwriter’s duty under subparagraph (A), when entering into or renewing a contract or agreement, it shall be the duty of the principal underwriter—

“(i) to provide the independent directors of a registered investment company with all material information about any of its business practice that may conflict with the best interests of the shareholders of the registered investment company; and

“(ii) to specify and commit to implement procedures that are reasonably designed to ensure services are provided in the best interests of such shareholders.

**“(D) INDEPENDENT DIRECTORS DUTY.—**In addition to the independent directors’ duty under subparagraph (A), it shall be the duty of the independent directors to determine whether the specified procedures of the investment adviser and the principal underwriter offer a reasonable likelihood of protecting the best interests of the shareholders of the registered investment company.

**“(3) LIMITATION ON CONSIDERATIONS.—**It shall be unlawful for the directors of a registered investment company, in connection with their evaluation of the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser of such company, to take into account the purchase price or other consideration any person may have paid in connection with a transaction of the type referred to in paragraph (1), (3), or (4) of subsection (f).”.

**SEC. 11. METHOD OF MAINTAINING BROKER/DEALER REGISTRATION, DISCIPLINARY, AND OTHER DATA.**

Subsection (i) of section 15A of the Securities Exchange Act of 1934 (15 U.S.C. 78o-3(i)) is amended to read as follows:

**“(i) OBLIGATION TO MAINTAIN REGISTRATION, DISCIPLINARY AND OTHER DATA.—**

**“(1) MAINTENANCE OF SYSTEM TO RESPOND TO INQUIRIES.—**A registered securities association shall—

“(A) establish and maintain a system for collecting and retaining registration information;

“(B) establish and maintain a toll-free telephone listing, and a readily accessible electronic or other process, to receive and promptly respond to inquiries regarding—

“(i) registration information on its members and their associated persons; and

“(ii) registration information on the members and their associated persons of any registered national securities exchange that uses the system described in subparagraph (A) for the registration of its members and their associated persons; and

“(C) adopt rules governing the process for making inquiries and the type, scope, and presentation of information to be provided in response to such inquiries in consultation with any registered national securities exchange providing information pursuant to subparagraph (B)(ii).

**“(2) RECOVERY OF COSTS.—**Such an association may charge persons making inquiries, other than individual investors, reasonable fees for responses to such inquiries.

**“(3) PROCESS FOR DISPUTED INFORMATION.—**Such an association shall adopt rules establishing an administrative process for disputing the accuracy of infor-

mation provided in response to inquiries under this subsection in consultation with any registered national securities exchange providing information pursuant to paragraph (1)(B)(ii).

“(4) LIMITATION OF LIABILITY.—Such an association, or exchange reporting information to such an association, shall not have any liability to any person for any actions taken or omitted in good faith under this subsection.

“(5) DEFINITION.—For purposes of this subsection, the term ‘registration information’ means the information reported in connection with the registration or licensing of brokers and dealers and their associated persons, including disciplinary actions, regulatory, judicial, and arbitration proceedings, and other information required by law, or exchange or association rule, and the source and status of such information.”

**SEC. 12. FILING DEPOSITORIES FOR INVESTMENT ADVISERS.**

(a) AMENDMENT.—Section 204 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-4) is amended—

(1) by striking “Every investment” and inserting the following:

“(a) IN GENERAL.—Every investment”; and

(2) by adding at the end the following:

“(b) FILING DEPOSITORIES.—The Commission may, by rule, require an investment adviser—

“(1) to file with the Commission any fee, application, report, or notice required to be filed by this title or the rules issued under this title through any entity designated by the Commission for that purpose; and

“(2) to pay the reasonable costs associated with such filing and the establishment and maintenance of the systems required by subsection (c).

“(c) ACCESS TO DISCIPLINARY AND OTHER INFORMATION.—

“(1) MAINTENANCE OF SYSTEM TO RESPOND TO INQUIRIES.—The Commission shall require the entity designated by the Commission under subsection (b)(1) to establish and maintain a toll-free telephone listing, and a readily accessible electronic or other process, to receive and promptly respond to inquiries regarding registration information (including disciplinary actions, regulatory, judicial, and arbitration proceedings, and other information required by law or rule to be reported) involving investment advisers and persons associated with investment advisers.

“(2) RECOVERY OF COSTS.—An entity designated by the Commission under subsection (b)(1) may charge persons making inquiries, other than individual investors, reasonable fees for responses to inquiries made under paragraph (1).

“(3) LIMITATION ON LIABILITY.—An entity designated by the Commission under subsection (b)(1) shall not have any liability to any person for any actions taken or omitted in good faith under this subsection.”

(b) CONFORMING AMENDMENTS.—

(1) Section 203A of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3a) is amended—

(A) by striking subsection (d); and

(B) by redesignating subsection (e) as subsection (d).

(2) Section 306 of the National Securities Markets Improvement Act of 1996 (15 U.S.C. 80b-10, note; P.L. 104-290; 110 Stat. 3439) is repealed.

**SEC. 13. LEAD INDEPENDENT DIRECTOR.**

Section 10(a) of the Investment Company Act of 1940 (15 U.S.C. 80a-10(a)) is amended—

(1) by inserting “(1)” after “(a)”; and

(2) by adding at the end the following new paragraph:

“(2) The board of directors of such a company shall select a lead independent director who is not an interested person and who shall (A) have authority to place items on the agenda for consideration, call meetings, and obtain outside advice on behalf of the independent directors, and (B) have such other authority as the Commission determines by rule to be necessary or useful. This paragraph shall not apply if the chairman of the board is an independent director.”

**SEC. 14. ENHANCED OVERSIGHT OF PERIODIC DISCLOSURES BY ISSUERS.**

Within 1 year after the date of enactment of this Act, the Securities and Exchange Commission—

(1) shall conduct a thorough review of the financial statements contained in the most recent periodic disclosures filed with the Commission by the largest 250 reporting issuers, and as many other reporting issuers as the Commission finds appropriate;

(2) shall query such issuers with respect to any confusing, ambiguous, or unclear statement in such disclosures that would be of interest to investors;

(3) shall require such issuers to respond fully to such queries, by such deadlines as the Commission may impose, and to clarify such statements as necessary for the protection of investors; and

(4) may require the issuer's response to be accompanied by an auditor's opinion as to—

(A) whether that response sets forth the information presented in accordance with generally accepted accounting principles, and

(B) whether the auditor reached that conclusion after applying generally accepted auditing standards to the information presented in the response.

#### SEC. 15. SENSE OF CONGRESS.

It is the sense of Congress that the Administrator of the Investor Education Fund of the 2003 Global Research Analyst Settlement should award—

(1) \$5,000,000 of the Investor Education Fund in the form of competitive grants to economic education programs administered by national non-profit educational organizations whose primary purpose is improving the quality of minority and low-income individuals' understanding of personal finance and economics; and

(2) \$5,000,000 of the Investor Education Fund in the form of competitive grants to economic education programs administered by national non-profit educational organizations whose primary purpose is improving the quality of elementary and secondary students' understanding of personal finance and economics.

#### PURPOSE AND SUMMARY

In the wake of a period in which many corporate officers were abusing their leadership positions to enhance their personal well-being at the expense of investors and their own corporations, H.R. 2179, the Securities Fraud Deterrence and Investor Restitution Act of 2003, provides the Securities and Exchange Commission (SEC or Commission) with enhanced ability to assist in returning fines and disgorgement proceeds back to investors. H.R. 2179 strengthens the Commission's enforcement capabilities and assists defrauded investors by improving the Commission's ability to prosecute wrongdoers, collect money from them, and return it to injured investors. The underlying goal of the legislation is to restore public confidence in the securities markets.

H.R. 2179 improves the SEC's ability to prosecute wrongdoers by granting the Commission additional authority to seek penalties in cease-and-desist proceedings. Currently, if the Commission finds cause to order a company or corporate officer to cease-and-desist from violating Federal securities laws and also seeks to impose a civil monetary penalty, two separate actions concerning the same facts must be filed. The bill improves the SEC's ability to collect money from wrongdoers—notwithstanding State homestead laws—by authorizing forced sales of property owned by a person against whom a judgment based on fraudulent conduct is obtained. Under current law, the Commission's staff must engage in protracted litigation to avoid State law exemptions. Finally, H.R. 2179 allows the Commission to use any penalties paid as a result of Commission actions to compensate investors injured by defendants in such actions.

#### BACKGROUND AND NEED FOR LEGISLATION

The Securities Fraud Deterrence and Investor Restitution Act of 2003 is an outgrowth of the Sarbanes-Oxley Act of 2002. Section 308(a) of that legislation established the Fair Fund, authorizing the SEC to take civil penalties collected in enforcement cases and add them to disgorgement funds for the benefit of victims of securities

laws violations. The Fair Fund provision was a groundbreaking measure to help the Commission return more funds to defrauded investors. Section 308(c) of Sarbanes-Oxley required the Commission to review, analyze, and report to Congress on its enforcement actions over the past five years to identify how those proceedings may best be utilized to return monies to defrauded investors. While section 308(a) has made available significantly more money for investor restitution, it was only a first step. In response to the Commission's report and subsequent testimony from the SEC before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises in February 2003, Chairmen Baker and Oxley introduced this legislation.

H.R. 2179 includes numerous provisions that will greatly increase the Commission's ability to investigate and deter fraud, levy and collect fines and disgorgement funds, and provide for a significant increase in money available for return to injured investors. Currently, there are numerous State and Federal procedural impediments that interfere with the Commission's ability to perform these functions. H.R. 2179 is common-sense, investor protection legislation that will reduce securities fraud violations, return money to defrauded investors, and help restore public confidence in the markets.

The legislation significantly improves the Commission's ability to satisfy judgments against securities law violators by removing State law impediments when the SEC seeks to enforce judgments based on securities fraud claims. All States have statutes that exempt certain property from collection by creditors. The Commission has encountered cases where people commit serious acts of securities fraud, which cause enormous investor losses and lead to multi-million dollar judgments, but then use these State law exemptions to shelter their assets from collection of these judgments. For example, in certain States, debtors can shelter millions of dollars in their homesteads that might otherwise be available for collection by the Commission. By excluding SEC securities fraud judgments from these State law property exemptions, this provision will increase the deterrent value of SEC enforcement actions against wrongdoers who attempt to shield their ill-gotten gains behind State homestead laws. It will also increase the assets available for recovery by the SEC and allow more of the proceeds of fraud to be returned to injured investors, a goal consistent with the Fair Fund provision.

H.R. 2179 would amend the Commission's existing administrative cease-and-desist authority to permit an imposition of civil monetary penalties in these proceedings, with a right of judicial review by a Federal court of appeals. Currently, the Commission must file two separate actions against the same entity or individual to obtain appropriate relief. By providing the Commission with authority to seek penalties in cease-and-desist proceedings, H.R. 2179 eliminates inefficiency and gives the Commission added flexibility to proceed administratively. In addition, the bill significantly increases the maximum fines imposed for violations of Federal securities laws to ensure meaningful penalties are assessed against wrongdoers.

The SEC's ability to trace money and relationships quickly and effectively in its investigations of wrongdoing would also be en-

hanced by allowing the Commission to obtain bank records to help identify financial relationships or arrangements among persons or entities that may be relevant to securities violations. H.R. 2179 gives the SEC the discretion in cases in which it has already authorized a formal investigation to obtain bank records without providing notice to the customer. Current law generally requires the SEC to provide customers with notice and ten or fourteen days to contest the SEC's request. This enables wrongdoers to take steps to hide evidence and otherwise impede the Commission's investigative efforts. Elimination of this requirement prevents efforts to hinder SEC investigations.

H.R. 2179 eliminates procedural hurdles faced by the Commission in the course of investigating and prosecuting securities fraud. The bill would give the Commission and banking regulators access to significant, otherwise unobtainable information by allowing (though not requiring) private parties to produce privileged or work-product protected documents to the Commission or appropriate banking regulator without waiving the privilege or protection as against any other party. The bill also allows the Department of Justice, subject to judicial approval in each case, to share grand jury information with the SEC in more circumstances than is currently permissible. In addition, the bill would provide nationwide service of subpoenas in civil actions brought by the SEC in the Federal courts to reduce costs and increase the effectiveness of Commission trial presentations. Furthermore, the SEC would have the express authority to contract with private collection attorneys to enhance the Commission's ability to recover more of the money owed by securities law violators.

The bill expands the use of the Fair Fund provision to benefit investors by allowing any civil penalty monies obtained in a Commission action to be used for distribution to victims. The Commission is also authorized to use undistributed portions of disgorgement funds established under Sarbanes-Oxley for investor education. On occasion, it may be the case that it is not feasible to distribute all disgorgement funds to victims of a violation; for example, if the amount of money collected is small and the number of potential victims is large—as in a small insider trading case—the costs of distribution may be so great relative to the size of the fund that it is not economically practical to administer a disgorgement fund.

In light of the widespread corporate scandals, closer cooperation between State and Federal regulators is imperative. H.R. 2179 requires the Commission to seek the cooperation of an association of State securities regulators to produce a joint study on strengthening the working relationship between State and Federal securities regulators. The study would be based on a previously announced initiative between the Commission and an organization of State securities administrators to improve the coordination, cooperation, and communication between State and Federal regulators.

H.R. 2179 also institutes significant reforms to mutual fund industry practices. The legislation requires the SEC to adopt a rule to prohibit registered open-end investment companies that are closed to new investors from charging 12b-1 fees to pay for any activity other than shareholder servicing. At their inception in 1980, 12b-1 fees were intended to assist small mutual funds to become

financially viable by using 12b-1 proceeds to cover their marketing and distribution costs and to help funds attract more assets. Today, 12b-1 fees are charged to investors in closed funds despite the fact that the fund is not seeking assets from new investors. An August 2003 Standard & Poor's study, which examined 15,000 funds, identified 139 funds that have closed their doors to new investors but continue to charge the 12b-1 fees. The same study found that 232 share classes closed to new investors were charging an average 12b-1 fee of 0.62 percent, while 74 funds were charging the regulatory maximum of 1 percent of the fund's net assets annually.

In addition, the bill requires the fund's investment adviser and principal underwriter to disclose material information relating to conflicts of interest between the investment adviser's or principal underwriter's business practices and the interests of mutual fund shareholders prior to the approval of a contract for services with a mutual fund. Section 15(c) of the Investment Company Act requires that a fund's directors must request and evaluate information necessary to evaluate the terms of an advisory or underwriting contract. The legislation shifts the obligation from the directors to the service providers to provide independent directors information relevant to their decision regarding the approval of an advisory or underwriting contract. Fund boards cannot control what they do not know; requiring fund service providers to disclose information about potential conflicts of interest, rather than making fund directors guess the questions they should be asking, will better protect mutual fund investors from such conflicts. Finally, if a mutual fund company does not have an independent chairman leading its board of directors, H.R. 2179 directs the board to designate a lead independent director.

H.R. 2179 also strengthens the tools available to investors to make more informed choices about their securities firms and brokers with whom they do business. Under Federal and State law, securities firms and brokers must provide information to regulators through a system operated by NASD. NASD currently maintains a toll-free telephone listing to receive inquiries regarding disciplinary actions involving its members and is required to respond to those inquiries in writing. H.R. 2179 would require NASD to establish a system to collect and maintain registration information and to establish an easily accessible electronic process to respond to inquiries about registration information, so that investors can access information about their securities firms and brokers online. NASD also would be required to adopt rules addressing the process for making inquiries and responses, and addressing the establishment of an administrative process for disputes that may arise concerning the accuracy of information given in response to inquiries. As under current law, the association and exchanges would not be liable to any person for actions taken or omitted in good faith under this provision.

This provision is important because informed investors are critical to market integrity and investor protection. Ready access to complete information about their securities firm and its brokers through NASD is critical to informing investors and building investor confidence. Investors have embraced the Internet as their preferred means of obtaining information about securities firms and brokers: of the over 2.5 million inquiries to NASD, 96 percent were

through the Internet and only 4 percent were by telephone. Investors want and need online access to disclosure information to assist them in deciding whether to do business with a securities firm or broker.

A provision in the bill builds on Section 408 of the Sarbanes-Oxley Act of 2002 and would enhance the Commission's review of the financial statements of the largest issuers. The provision requires the agency to conduct a thorough review of the financial statements contained in the most recent periodic disclosures filed by the 250 largest reporting issuers. Congress sought to enhance the review of periodic disclosures in the Sarbanes-Oxley Act by requiring the Commission to review each issuer's disclosures no less frequently than once every three years.

The 2003 Global Research Analyst Settlement established a \$52.5 million Investor Education Fund to develop and support programs to equip investors with the knowledge and skills to make informed decisions. H.R. 2179 includes a Sense of Congress that the administrator of the fund should award \$5 million in competitive grants to programs administered by national non-profit educational organizations whose primary purpose is improving the quality of minority and low income individuals' understanding of personal finance and economics. Five million dollars should be awarded in the form of competitive grants to programs administered by national non-profit educational organizations whose primary purpose is improving the quality of elementary and secondary students' understanding of personal finance and economics.

#### HEARINGS

On June 5, 2003, the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises held a hearing on H.R. 2179. The following witnesses testified: Mr. Stephen M. Cutler, Director, Division of Enforcement, the U.S. Securities and Exchange Commission; Ms. Mary L. Schapiro, Vice Chairman and President, Regulatory Policy and Oversight, National Association of Securities Dealers; and Ms. Christine A. Bruenn, President, North American Securities Administrators Association, Inc.

#### COMMITTEE CONSIDERATION

The Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises met in open session on July 10, 2003 and approved H.R. 2179 for full Committee consideration, as amended, by a voice vote.

The Committee on Financial Services met in open session on February 25, 2004 and ordered H.R. 2179 reported to the House, with an amendment, with a favorable recommendation, by a voice vote.

#### COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. A motion by Mr. Oxley to report the bill to the House with a favorable recommendation was agreed to by a voice vote.

The following amendment was considered by a record vote:

An amendment to the amendment in the nature of a substitute by Mr. Hensarling, No. 1g, regarding a homestead exemption, was not agreed to by a record vote of 18 yeas and 29 nays (Record vote No. FC-15).

RECORD VOTE NO. FC-15

Representative	Aye	Nay	Present	Representative	Aye	Nay	Present
Mr. Oxley	X			Mr. Frank (MA)		X	
Mr. Leach	X			Mr. Kanjorski		X	
Mr. Bereuter	X			Ms. Waters		X	
Mr. Baker				Mr. Sanders*		X	
Mr. Bachus				Mrs. Maloney		X	
Mr. Castle	X			Mr. Gutierrez		X	
Mr. King	X			Ms. Velázquez		X	
Mr. Royce		X		Mr. Watt		X	
Mr. Lucas (OK)		X		Mr. Ackerman		X	
Mr. Ney				Ms. Hooley (OR)		X	
Mrs. Kelly		X		Ms. Carson (IN)		X	
Mr. Paul				Mr. Sherman			
Mr. Gillmor				Mr. Meeks (NY)			
Mr. Ryun (KS)	X			Ms. Lee		X	
Mr. LaTourette				Mr. Inslee		X	
Mr. Manzullo				Mr. Moore			
Mr. Jones (NC)				Mr. Capuano		X	
Mr. Ose				Mr. Ford			
Mrs. Biggert				Mr. Hinojosa	X		
Mr. Green (WI)		X		Mr. Lucas (KY)	X		
Mr. Toomey		X		Mr. Crowley		X	
Mr. Shays				Mr. Clay		X	
Mr. Shadegg	X			Mr. Israel			
Mr. Fossella				Mr. Ross		X	
Mr. Gary G. Miller (CA)				Mrs. McCarthy (NY)		X	
Ms. Hart		X		Mr. Baca		X	
Mrs. Capito				Mr. Matheson			
Mr. Tiberi		X		Mr. Lynch			
Mr. Kennedy (MN)				Mr. Miller (NC)		X	
Mr. Feeney	X			Mr. Emanuel		X	
Mr. Hensarling	X			Mr. Scott (GA)		X	
Mr. Garrett (NJ)	X			Mr. Davis (AL)		X	
Mr. Murphy	X			Mr. Bell	X		
Ms. Ginny Brown-Waite (FL)	X						
Mr. Barrett (SC)	X						
Ms. Harris							
Mr. Renzi	X						

\* Mr. Sanders is an independent, but caucuses with the Democratic Caucus.

The following other amendments were also considered:

An amendment in the nature of a substitute by Mr. Oxley, No. 1, revising section 8(b) and making other technical changes, was agreed to by a voice vote, as amended.

An amendment to the amendment in the nature of a substitute by Mr. Frank of Massachusetts, No. 1a, requiring volunteer participation of association in an SEC study, was agreed to by a voice vote.

An amendment to the amendment in the nature of a substitute by Mr. Castle, No. 1b, requiring a reduction of excessive distribution and marketing fees, was agreed to by a voice vote.

An amendment to the amendment in the nature of a substitute by Mr. Baker, No. 1c, requiring advisory fee comparison of mutual fund shareholders and institutional investors, was withdrawn.

An amendment to the amendment in the nature of a substitute by Mr. Gillmor, No. 1d, requiring disclosure responsibilities at contract renewal, was agreed to by a voice vote.

An amendment to the amendment in the nature of a substitute by Mr. Shadegg, No. 1e, providing access to regulatory data, was agreed to by a voice vote.

An amendment to the amendment in the nature of a substitute by Ms. Harris, No. 1f, providing a limitation to property derived from proceeds of illegal actions, was not agreed to by a voice vote.

An amendment to the amendment in the nature of a substitute by Ms. Harris, No. 1h, providing a limitation to judicial actions only, was not agreed to by a voice vote.

An amendment to the amendment in the nature of a substitute by Mr. Miller of North Carolina, No. 1i, regarding a lead independent director, was agreed to by a voice vote.

#### COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee held a hearing and made findings that are reflected in this report.

#### PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee establishes the following performance related goals and objectives for this legislation:

The Securities and Exchange Commission will utilize the authorities granted under this legislation to better enforce the securities laws, improve investor protection, return disgorged funds to injured investors, and undertake such other actions as may be necessary to improve investor confidence in the securities markets.

#### NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee finds that this legislation would result in no new budget authority, entitlement authority, or tax expenditures or revenues.

#### COMMITTEE COST ESTIMATE

The Committee adopts as its own the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

#### CONGRESSIONAL BUDGET OFFICE ESTIMATE

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

U.S. CONGRESS,  
CONGRESSIONAL BUDGET OFFICE,  
*Washington, DC, April 23, 2004.*

Hon. MICHAEL G. OXLEY,  
*Chairman, Committee on Financial Services,  
House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 2179, the Securities Fraud Deterrence and Investor Restitution Act of 2004.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Melissa E. Zimmerman.  
Sincerely,

DOUGLAS HOLTZ-EAKIN,  
*Director.*

Enclosure.

*H.R. 2179—Securities Fraud Deterrence and Investor Restitution Act of 2004*

Summary: H.R. 2179 would increase the maximum amount of civil penalties assessed for violating securities laws and regulations and would direct the Securities and Exchange Commission (SEC) to use such penalty collections to compensate victims of such violations. The SEC also would be authorized to use those collections to compensate private debt collectors for collecting such penalties and could spend any remaining penalty collections on investor education programs. Finally, the bill would direct the SEC to make several amendments and updates to securities laws pertaining to the investment industry.

CBO estimates that enacting S. 2179 would increase revenues by about \$720 million in 2004, \$15.1 billion over the 2004–2009 period, and \$29.5 billion over the 2004–2014 period; it would increase direct spending by about \$1 billion in 2004, \$17 billion over the 2004–2009 period, and \$33 billion over the 2004–2014 period. The net budgetary impact of the bill would be a decrease in the deficit of about \$460 million in 2004, a net increase in deficits of \$320 million over the 2004–2009 period, and a net increase in deficits of about \$1.9 billion over the 2004–2014 period. Budget deficits would increase under H.R. 2179 because penalties currently being collected by the SEC (but unspent under current law) would be spent under the bill. Implementing the bill would not have a significant effect on spending subject to appropriation.

H.R. 2179 contains an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA), but CBO estimates that the resulting costs would not be significant and would not exceed the threshold established in UMRA (\$60 million in 2004, adjusted annually for inflation).

H.R. 2179 would impose private-sector mandates as defined in UMRA on certain companies, associations, and individuals involved in the securities industry. Based on information provided by industry and government sources, CBO expects that the aggregate direct costs of complying with those mandates would fall below the annual threshold established by UMRA for private-sector mandates (\$120 million in 2004, adjusted annually for inflation).

Estimated cost to the Federal Government: The estimated budgetary impact of H.R. 2179 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce and housing credit).

	By fiscal year, in billions of dollars—										
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	CHANGES IN REVENUES										
Estimated Revenues .....	0.7	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9
	CHANGES IN DIRECT SPENDING										
Estimated Budget Authority .....	1.0	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2
Estimated Outlays .....	0.3	2.4	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2
	CHANGES IN DEFICITS										
Estimated Net Increase In the Deficits ....	-0.5	-0.5	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3

Note.—Components may not sum to totals because of rounding.

**Basis of Estimate:** CBO estimates that S. 2179 would increase the annual level of penalties imposed by the SEC approximately tenfold. The bill would authorize the SEC to spend all penalties collected under current law—as well as the new higher collections generated by the bill. Thus the net budgetary impact of the bill would be the spending of amounts collected under the current penalty structure. Under current law, these amounts are deposited in the Treasury and are not available for spending.

CBO estimates that the net budgetary impact of the bill would be a decrease in the deficit of about \$460 million in 2004, a net increase in deficits of \$320 million over the 2004–2009 period, and a net increase in deficits of about \$1.9 billion over the 2004–2014 period.

#### *Revenues*

Section 3 would increase maximum civil penalties for violations of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisers Act of 1940. Such violations include insider trading and fraud and deceit in the offer, purchase, or sale of securities. According to the SEC, collections of such penalties were about \$250 million in 2003 and about \$230 million for the first half of 2004. The bill would increase the maximum penalty by roughly tenfold, depending on the severity of the violation. For example, the maximum penalty for violations of the Securities Act of 1933 for individuals would increase from \$100,000 to \$1 million.

Based on information regarding collections in 2003 and 2004 provided by the SEC, CBO estimates that enacting S. 2179 would increase revenues by about \$720 million in 2004, \$15.1 billion over the 2004–2008 period, and \$29.5 billion over the 2004–2014 period. This estimate does not assume any significant decline in the number of violations. The increase in collections could be much higher or lower considering that the amount of penalties varies widely from year to year.

#### *Direct Spending*

Section 8 of the S. 2179 would direct the SEC to place all civil penalties it collects into disgorgement funds to compensate victims of violations of securities laws and regulations. If the victim of a

violation cannot be identified or located, or the amounts remaining are too small to merit distribution, the SEC could request that the penalty collections be used to fund investor education programs administered by a nonprofit or government organization. In addition, section 7 of the bill would authorize the SEC to contract with private firms to collect penalties assessed for violations of securities laws and regulations and to compensate the private firms using the amounts they recover. Under current law, the SEC is not authorized to spend penalty collections.

Based on information provided by the SEC, CBO estimates that enacting S. 2179 would increase direct spending for compensating victims, funding investor education, and compensating private debt collectors by more than the increase in penalty amounts that would occur under the bill. CBO estimates that spending would increase under the bill by about \$1 billion in 2004, \$17 billion over the 2004–2009 period, and \$33 billion over the 2004–2014 period. The increase in spending could be much higher or lower considering that the amount of penalties collected varies widely from year to year.

#### *Spending Subject to Appropriation*

**Reviews of Financial Statements.** Section 14 would require the SEC to review the most recent financial statements disclosed by the largest 250 reporting issuers. According to the SEC, the agency is already in the process of conducting financial reviews for several issuers and would not require significant additional resources to complete the review required by section 14. Therefore, CBO estimates that implementing this provision would not have a significant effect on spending subject to appropriation.

**Investment Industry Regulations.** Several provisions in S. 2179 would make changes to regulations involving the investment industry. In particular, the bill would affect rules with regard to mutual fund management, disclosure of potential conflicts of interest by financial professionals, and accessibility of information about registered securities associations. Based on information provided by the SEC, CBO estimates that implementing those changes would not have a significant effect on spending subject to appropriation.

**Estimated impact on state, local, and tribal governments:** Section 2 would preempt laws in almost all states by allowing properties otherwise covered by homestead provisions to be seized by federal securities authorities. (Generally, state homestead exemptions protect a certain amount of property from seizure during a bankruptcy or other proceeding.) That preemption constitutes a mandate as defined in UMRA. Although states may incur some costs due to this provision, CBO estimates that such costs would fall significantly below the threshold established in UMRA (\$60 million in 2004, adjusted annually for inflation) because most homestead exemptions protect very limited assets. Any costs incurred by states for participating in the federal and state cooperation study established in section 8 or contributing to the relief of victims fund would be voluntary.

**Estimated impact on the private sector:** H.R. 2179 would impose private-sector mandates as defined in UMRA on certain companies, associations, and individuals involved in the securities industry. Based on information provided by industry and government

sources, CBO expects that the aggregate direct costs of complying with those mandates would fall below the annual threshold established by UMRA for private-sector mandates (\$120 million in 2004, adjusted annually for inflation).

*Prohibition of Certain Distribution and Marketing Fees*

Under current law, the Securities and Exchange Commission rule 12b-1 allows mutual funds to assess fees on shareholders for fund marketing, distribution, and certain other costs. The bill would prohibit mutual fund companies from charging any fees under rule 12b-1, except fees for shareholder servicing activities, on mutual funds that are closed to new investors. Based on information from industry experts and government sources, CBO interprets the language of that provision to mean that while marketing and distribution fees would be prohibited, other fees could still be charged, although not under SEC rule 12b-1. According to information from industry and government sources, about 150 mutual funds are closed to new investors, and such funds charge approximately \$10 million to \$15 million per year in marketing and distributing fees under rule 12b-1. The direct cost of the mandate would be the loss of those fees less the administrative cost to collect them. The cost of the mandate could be significantly higher, however, if the SEC interprets the language differently and prohibits funds from collecting other fees currently collected under rule 12b-1 in promulgating the rules and regulations for this provision.

*Access to Information and Corporate Governance*

The bill would impose other private-sector mandates regarding additional disclosures, consumer information, and corporate governance. Based on information from industry and government sources, CBO estimates that the direct cost to comply with those mandates would be small. Those mandates would:

- Prohibit companies and individuals from disclosing in certain instances that financial records have been requested by the SEC;
- Require investment advisers and principal underwriters to disclose certain material information to the board of directors of a registered investment company when entering into or renewing a contract or agreement;
- Require a registered securities association to establish and maintain a readily accessible electronic or other process to respond to certain inquiries regarding brokers, including information about the registration and licensing of brokers, and disciplinary actions;
- Require investment advisers to pay fees to cover the cost of systems set up to respond to certain inquiries regarding investment advisers if such a system is established by the SEC; and
- Require the board of directors of a registered investment company to select a lead independent director, unless the chairman of the board is an independent director.

Estimate prepared by: Federal Costs: Melissa E. Zimmerman; Impact on State, Local, and Tribal Governments: Sarah Puro; and Impact on the Private Sector: Paige Piper/Bach.

Estimate approved by: Peter H. Fontaine, Deputy Assistant Director for Budget Analysis. Robert Williams, Deputy Assistant Director for Tax Analysis.

#### FEDERAL MANDATES STATEMENT

The Committee adopts as its own the estimate of Federal mandates prepared by the Director of the Congressional Budget Office pursuant to section 423 of the Unfunded Mandates Reform Act.

#### ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

#### CONSTITUTIONAL AUTHORITY STATEMENT

Pursuant to clause 3(d)(1) of rule XIII of the Rules of the House of Representatives, the Committee finds that the Constitutional Authority of Congress to enact this legislation is provided by Article 1, section 8, clause 1 (relating to the general welfare of the United States) and clause 3 (relating to the power to regulate interstate commerce).

#### APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of section 102(b)(3) of the Congressional Accountability Act.

#### SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

##### *Section 1. Short title*

This section provides the short title of the legislation, the "Securities Fraud Deterrence and Investor Restitution Act of 2004".

##### *Section 2. Recovery by Commission of Securities law judgments*

Section 2 amends the Sarbanes-Oxley Act in order to give the Commission greater ability to satisfy judgments against fraudsters by removing State law impediments when the SEC seeks to enforce judgments based on securities fraud claims.

All States have statutes that exempt certain property from collection by creditors. The Commission has encountered cases where persons commit serious securities frauds, which cause enormous investor losses and lead to multi-million dollar judgments, but then use these State law exemptions to shelter their assets from collection of these judgments. For example, in certain States, debtors can shelter millions of dollars in their homesteads that might otherwise be available for collection by the Commission. By excluding SEC securities fraud judgments from such State law property exemptions, this provision will increase the deterrent value of SEC enforcement actions against wrongdoers who attempt to shield their ill-gotten gains behind State homestead laws.

Notably, this provision does not alter existing law on the validity or priority of liens in property that the SEC pursues to satisfy a judgment or order. The validity of any lienholders' rights or claims and their rights to take possession, in whole or in part, of the prop-

erty or the proceeds from the sale of the property will continue to be determined in accordance with other applicable law. In sum, Section 2 will also increase the assets available for recovery by the SEC and allow more of the proceeds of fraud to be returned to injured investors, a goal consistent with the Fair Funds provision of the Sarbanes-Oxley Act.

### *Section 3. Civil enforcement provisions*

This provision contains several measures to strengthen the SEC's ability to investigate, punish and deter securities law violations.

First, subsection (a) amends the Commission's existing administrative cease-and-desist authority to permit the Commission to impose civil money penalties in these proceedings, with a right of judicial review by a Federal court of appeals. Currently, the Commission has two means of seeking civil penalties: in administrative proceedings against entities and persons directly regulated by the Commission, such as broker-dealers or registered representatives; or in Federal court actions against any entity or person (whether or not directly regulated by the SEC). The Commission also has authority to seek remedies other than civil penalties against any entity or person in an administrative proceeding.

The result of this patchwork is that in some circumstances the Commission must file two separate actions against the same entity or individual to obtain the appropriate array of relief. By granting the Commission authority to seek penalties in cease-and-desist proceedings, this section would eliminate inefficiency and give the Commission added flexibility to proceed administratively. The section also would ensure appropriate due process protections for subjects of administrative penalty proceedings by making the Commission's authority to seek penalties in this context coextensive with its authority to seek penalties in Federal court. As is the case when a Federal district court imposes a civil penalty in a Commission action, imposition of a civil penalty in an administrative cease-and-desist proceeding would be appealable to a Federal court of appeals.

Second, subsection (b) significantly increases the maximum fines that the SEC and courts can impose for violations. Currently, the civil fine provisions contain maximum penalties ranging from \$6,500 to \$600,000 per violation. While these statutory maximums have been adjusted for inflation, the increases have not kept pace with the exponential growth of our capital markets over the past ten years, and have not had the desired deterrent effect on individual or corporate violators. In light of the massive securities frauds witnessed in recent years, an increase in the current maximum fines will help ensure that the SEC is able to impose meaningful penalties against wrongdoers.

Third, subsection (c) contains an important provision to enhance the SEC's ability to trace money and relationships quickly and effectively in its investigations of wrongdoing. During its investigations, the SEC often seeks to obtain bank records to help identify financial relationships or arrangements among persons or entities that may be relevant to securities violations. Identifying those relationships or arrangements, and quickly identifying assets obtained or transferred in connection with possible unlawful activity, is critical to the SEC's ability to obtain orders freezing assets of wrong-

doers. In many situations, the SEC could more effectively identify and preserve illegal proceeds if it could obtain relevant bank records without providing notice to the persons whose account records are sought.

Current law, however, generally requires that the SEC provide those persons with notice and a substantial period (10 or 14 days) to contest the SEC's request. Although current law permits the SEC to seek court authorization to obtain the relevant bank records without notifying the subject for up to 90 days, important investigative objectives can be compromised by the inherent delay in obtaining the necessary court order.

The legislation addresses both the notice and delay problems by giving the SEC the discretion—though only in those cases in which it has already authorized a formal investigation—to proceed without notice to the customer. The legislation also reiterates and strengthens the SEC's authority to require that financial institutions not compromise investigations by notifying customers that their bank records have been subpoenaed. This change will enhance the SEC's ability to investigate and take effective action quickly.

#### *Section 4. Authority to accept privileged and protected information*

This provision enhances the Commission's access to significant, otherwise unobtainable information by allowing (though not requiring) private parties to produce privileged or work-product protected documents to the Commission without waiving the privilege or protection as against any other party.

Voluntary production of information that is protected by the attorney-client privilege, other privileges, or the attorney work product doctrine greatly enhances the Commission's investigative efforts, and in some cases makes them more efficient. In many cases, private parties would be willing to share privileged information with the Commission if they could otherwise maintain the privileged and confidential nature of the document. For example, a company that retains outside counsel to conduct an internal investigation concerning possible violations may be willing to share the investigative report with the Commission. Under current law, however, a party who produces privileged or protected material to the Commission runs a very serious risk that a third party, such as an adversary in private litigation, could obtain that information by successfully arguing that production to the Commission waived the privilege or protection. This presents a substantial disincentive for anyone who might otherwise consider providing the Commission useful information that is subject to a privilege or protection.

Section 4 minimizes that disincentive. It does not require anyone to produce privileged or protected material to the Commission, but it does allow parties who choose to produce such materials to do so without fear that their production to the Commission will be deemed to waive the privilege or protection as to anyone else. This provision provides that a person generally does not waive any applicable privilege, under Federal or State law, or any protection under the work product doctrine, when a person produces or discloses any information or document to the Commission or an appropriate regulatory agency subject to the terms of a written agreement. The production or disclosure of information or a document

does not constitute a waiver of the privilege or protection as to any person other than the Commission or the appropriate regulatory agency to which the document or information is provided. The term “appropriate regulatory agency” means the four Federal banking agencies—the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), or the Board of Governors of the Federal Reserve System (Fed).

The protections of a clear rule that a person will not lose any applicable privilege or protection that the person is entitled to assert will help ensure that these Federal functional regulators receive necessary information about the respective financial services providers that they regulate and that there is a free flow of information between the regulated entity and the Federal regulator. The provision does not authorize the Commission or an appropriate regulatory agency to obtain any information or document from any person that the agency is prohibited from obtaining under another provision of law and it does not relieve any person of liability for providing any information or document to the Commission or an appropriate regulatory agency that the person is prohibited from providing under other law.

This provision does not in any manner limit or interfere with the authority that the Commission, the OCC, the FDIC, the Fed, or the OTS has under other law to obtain documents and information from the entities that these Federal functional regulators regulate and supervise. Moreover, this provision does not address whether a person would waive any applicable Federal or State privilege or protection by providing information or documents to a Federal functional regulator outside of a written agreement; such issues would continue to be governed by existing law.

This provision also should assist the Commission’s examination program by allowing registrants to preserve their privileges and protections as to third parties when they produce required records and reports to the Commission. Under the Commission’s examination authority, and in particular its authority to examine “all” records of brokers, dealers, national securities exchanges, national securities associations, transfer agents, investment advisers and other entities registered under the Securities Exchange Act of 1934 or the Investment Advisers Act of 1940, the Commission has the authority to require the production of records that might otherwise be privileged or subject to the protection provided by the work product doctrine. Section 4’s amendment to Section 24 of the Securities and Exchange Act would allow registrants to preserve their privileges and protections as to third parties notwithstanding the production of records to Commission examiners.

#### *Section 5. Access to grand jury information*

Section 5 authorizes the Department of Justice, subject to judicial approval in each case, to share grand jury information with the SEC in more circumstances and at an earlier stage than is currently permissible.

Under existing law, Federal Rule of Criminal Procedure 6(e) prohibits disclosure of “matters occurring before the grand jury,” unless that disclosure falls within one of the Rule’s limited exceptions. Under those exceptions, the Commission may obtain grand jury in-

formation only in the rare case in which it can demonstrate that it has a “particularized need” for the information and that the information is sought “preliminarily to or in connection with a judicial proceeding.” As a practical matter, these requirements severely limit the situations in which the Department of Justice can share with the Commission even the most critical information relevant to parallel investigations. In most cases, the Commission must conduct a separate, duplicative investigation to obtain the same information. This not only creates an inefficient use of government resources and substantial delay in Commission action, but burdens private parties and financial institutions who may have to provide essentially the same documents and testimony in multiple investigations.

This section provides a narrow modification of the grand jury secrecy rule, in order to aid the Commission in its investigations and enhance the efficient use of law enforcement resources devoted to those investigations. It would authorize Department of Justice attorneys to seek court authorization to release limited grand jury information to Commission personnel for use in matters within the Commission’s jurisdiction. It permits sharing of information only with regard to conduct that may constitute violations of the Federal securities laws, but lessens the burden in obtaining court approval for sharing that information. The court could approve the sharing of the information upon a showing of a “substantial need in the public interest,” rather than the higher “particularized need” standard. The public interest standard would allow the court to consider the protection of investors as a reason for permitting access to the grand jury material. Other factors the court could consider under this standard would include: (1) the burden or cost of duplicating the grand jury investigation; (2) the potential unavailability of witnesses; (3) the fact that the SEC already has a legitimate independent right to the same materials; (4) the avoidance of inefficiency or waste of resources; (5) the need to prevent ongoing violations of law; and (6) the expiration of an applicable statute of limitations. In addition, under this section the judicial proceeding requirement would not apply to the Commission, permitting information to be shared at an earlier stage in an investigation and in connection with an administrative proceeding.

#### *Section 6. Nationwide service of process*

This provision provides for nationwide service of subpoenas in civil actions brought by the SEC in the Federal courts, which will reduce costs and increase the effectiveness of Commission trial presentations. Other Federal agencies with comparable missions have long had this nationwide service authority. The Commission currently has authority for nationwide service in administrative proceedings. For civil actions filed in Federal district court, however, the Commission does not have the ability to effect nationwide service of process for trial subpoenas on witnesses.

Under existing law, the Commission issues trial subpoenas in Federal court actions pursuant to Rule 45 of the Federal Rules of Civil Procedure. That Rule provides that a subpoena may only be issued within the judicial district where the trial takes place or within a “100-mile bulge” from the courthouse. Witnesses in SEC cases are frequently located outside of the trial court’s subpoena

range. Unless such a witness volunteers to appear at trial, the SEC must first take the witness's deposition, and then use his or her written or videotaped deposition testimony at trial. Deposition testimony is more expensive, and less effective, than live testimony.

By eliminating the application of Rule 45's geographical limitations to the SEC, this section will provide substantial advantages, including significant savings in the costs of creating and presenting videotaped deposition testimony, as well as significant savings in travel costs and SEC staff time due to the elimination of unnecessary depositions. It will also provide the benefits of live witnesses before the trial court.

*Section 7. Authority to contract with private counsel for legal services to collect delinquent judgments and orders*

This provision would give the SEC express authority to hire private counsel to provide legal services, including litigation, for the collection of unpaid debt owed by securities law violators.

The SEC obtains judgments or orders for millions of dollars in disgorgement and penalties from violators each year, but many of these violators fail to pay the amounts they owe. The Commission takes steps, consistent with its existing authority, to try to collect these obligations. When, however, these efforts are unsuccessful, it does not have the express authority to then retain private debt collection counsel to pursue the matter further. By giving the SEC this express authority, modeled on a similar statutory provision applicable to the Department of Justice, section 7 enhances the Commission's ability to recover more of the money owed by securities law violators. Private collection attorneys have more familiarity with local procedures for debt collection. By hiring private attorneys with collection expertise, the Commission would not need to divert as many enforcement staff resources to collection efforts. This will allow SEC enforcement staff to focus more of its efforts on its primary functions of detecting, investigating, stopping, and prosecuting securities law violations.

*Section 8. Fair Act amendments*

Section 8 contains several amendments to the Fair Funds provision of the Sarbanes-Oxley Act to provide for expanded use of Fair Funds to benefit investors. First, it amends the current Fair Funds provision to allow any civil penalty monies obtained in a Commission action to be used for distribution to victims. Currently, under the Fair Funds provision, the Commission is authorized to add penalty monies collected in its enforcement cases to disgorgement amounts to create funds for the benefit of victims of a securities law violation, if the penalty is collected from the same defendant who has been ordered to pay disgorgement. This section would expand the application of the Fair Funds provision to permit any penalty monies obtained by the Commission to be added to a fund for the benefit of victims of the violation.

This section also amends the Fair Funds provision to provide that the Commission may allow a State that has received penalty or disgorgement payments pursuant to a settlement in a securities fraud action to contribute those payments to a fund administered by the Commission for the purpose of making restitution payments to investors. This provision will provide a mechanism by which a

State could contribute monies obtained in a settlement of a securities fraud action to a fund for the benefit of investors administered by the Commission. In no event would a State be required to do so, and the contribution to the fund would be subject to the Commission's discretion. In many cases, however, it may be more efficient for a State to distribute monies to investors through such a fund administered by the Commission.

Finally, section 8 adds a new provision to the Fair Funds provision to allow the SEC to require that undistributed portions of funds established for the benefit of victims be used for investor education. On occasion, it may not be feasible to distribute all monies in a fund created for the benefit of victims of a violation. For example, if the amount of money collected is small and the number of victims is large—as in a small insider trading case—the costs of distribution may be so great relative to the size of the fund that it is not economically practical to administer the fund. If the Commission determines, for this or any other reason, that distribution of a fund is not feasible, or if there are excess monies remaining after distribution, then the Commission may move for an order in a judicial action, or may issue an order in an administrative action, directing that the undistributed amount of the fund be used for investor education purposes. The Court or Commission order may provide for the use of these funds for programs administered by an established not-for-profit or governmental organization whose purposes include investor education and financial literacy, and may provide for either direct payment of the monies to the investor education program, or for the appointment of a fund administrator to monitor use of the funds.

Section 8 also requires the Commission to seek to produce in cooperation with an association of State securities regulators a joint study on strengthening the working relationship between State and Federal securities regulators. State and Federal securities regulators historically have worked in tandem on oversight of the securities industry. In light of recent corporate scandals, closer cooperation between State and Federal regulators has become even more imperative. The joint study would be based on a previously announced initiative between the Commission and the North American Securities Administrators Association to improve the coordination, cooperation and communication between State and Federal regulators. If the association of State securities regulators agrees to participate in the study, the results would be jointly reported to both the House Committee on Financial Services and the Senate Committee on Banking, Housing and Urban Affairs by September 14, 2005, or one year after the enactment of this legislation, whichever is later.

#### *Section 9. Reduction of excessive distribution and marketing fees*

Section 9 requires the Commission, within 90 days of the bill's enactment, to adopt a rule to prohibit registered open-end investment companies that are closed to new investors from charging fees under a 12b-1 plan to pay for any activity other than shareholder servicing.

Section 12(b) of the Investment Company Act of 1940 makes it unlawful for a registered open-end investment company (fund) to act as a distributor of securities of which it is the issuer, except

through an underwriter, in contravention of Commission regulations. Section 12(b) was intended to protect funds from bearing excessive sales and promotion expenses. Rule 12b-1 permits funds to use their assets to pay distribution-related costs. In order to rely on the rule, a fund must comply with certain conditions, including adopting “a written plan describing all material aspects of the proposed financing of distribution” that is approved by fund shareholders and fund directors.

The Commission adopted the rule in 1980, when many funds were facing net redemptions of fund assets, and anticipated that 12b-1 fees would be used as temporary measures to replenish fund assets. Since then, many funds have adopted 12b-1 plans and rely on 12b-1 fees to serve as a substitute for front-end sales charges and to compensate financial intermediaries for the services they provide to existing shareholder accounts. The provision would preclude funds that are closed to new investors and, therefore, are not seeking additional assets, from continuing to collect 12b-1 fees.

*Section 10. Disclosure responsibilities at contract renewal*

Section 10 requires the disclosure of material information relating to any conflict of interest between an investment adviser’s and principal underwriter’s business practices and the interests of the shareholders of a fund prior to the approval of a contract for services with the fund.

Currently, under section 15(c) of the Investment Company Act of 1940, funds cannot enter into, renew or perform any contract with an investment adviser or principal underwriter unless the contract or renewal has been approved by an in-person vote of a majority of independent directors at a meeting held for that purpose. The directors of a fund have a duty to request and evaluate, and the investment adviser has a duty to furnish, any information reasonably necessary to evaluate the terms of an investment advisory contract with the fund.

Section 10 imposes the same duties on directors and principal underwriters with respect to an underwriting contract with the fund.

In addition, section 10 specifies the duties of investment advisers, principal underwriters, and independent directors of a fund when negotiating a contract for services. It requires an investment adviser, when entering into or renewing a contract or agreement, to disclose to the independent directors material information concerning any business practices of the adviser, or of its affiliates, that may conflict with the best interests of the fund’s shareholders. It also requires the investment adviser to specify and commit to implement procedures reasonably designed to ensure that its services are provided in the best interests of the fund’s shareholders. Principal underwriters would have the same duties when entering into or renewing an underwriting contract with a fund.

Finally, section 10 would require independent directors to determine whether the procedures specified by the investment adviser and the principal underwriter offer a reasonable likelihood of protecting the best interests of the fund’s shareholders.

*Section 11. Method of maintaining broker/dealer registration, disciplinary and other data*

Section 11 amends section 15A(i) of the Securities Exchange Act of 1934, which requires a registered securities association to maintain a toll-free telephone listing to receive inquiries regarding disciplinary actions involving its members and their associated persons, and to respond to those inquiries in writing. The amended language would require a registered securities association to establish a system to collect and maintain registration information, and to establish an easily accessible electronic or other process (in addition to the toll-free telephone listing) to respond to inquiries about registration information.

Registration information would be collected on the association's members and their associated persons, as well as the members and associated persons of any registered national securities exchange that uses the system for the registration of such persons. The association may charge persons making inquiries, other than an individual investor, reasonable fees for producing a response.

The registered securities association, in consultation with the participating registered national securities exchanges, also would be required to adopt rules on the process for making inquiries and responses, and on the establishment of an administrative process for disputes that may arise concerning the accuracy of information given in responses to inquiries. As under current law, the association and participating exchanges would not be liable to any persons for actions taken or omitted in good faith under this provision.

*Section 12. Filing depositories for investment advisers*

Section 12 reorganizes and codifies in the Investment Advisers Act of 1940 provisions of the National Securities Markets Improvement Act of 1996, in which Congress directed the Commission to establish an electronic filing system, and mandated the creation of a public disclosure program, for investment advisers. Pursuant to this directive, the Commission designated the NASD to operate the electronic filing system for investment advisers, which is called the Investment Adviser Registration Depository, and created an Internet-based public disclosure program containing investment adviser registration and disciplinary information.

Section 12 codifies this arrangement, although it would require a toll-free telephone listing, as well as an electronic means, for receiving and responding to inquiries for registration information.

The new provision recognizes that the NASD also operates the public disclosure program on behalf of the Commission and conforms the Investment Advisers Act provision to the terms of the Securities Exchange Act of 1934 so that the NASD has immunity from liability for actions taken in good faith in operating the investment adviser public disclosure program.

*Section 13. Lead independent director*

This provision requires that if a registered open-end investment company does not have an independent chairperson leading its board of directors, the board of directors must designate a lead independent director, i.e., a lead director who is not an "interested person." A lead independent director would have authority to place items on the board's agenda, call meetings, and seek outside advice

for the independent directors. The Commission, by rule, may give the lead independent director such additional authority as it determines to be necessary or useful.

*Section 14. Enhanced oversight of periodic disclosures by issuers*

This provision enhances the Commission's review of the financial statements of the largest issuers. The Commission historically has conducted reviews of the financial statements and other periodic disclosures of issuers on a cyclical basis. Because of the large number of issuers and finite staff resources, however, the Commission could not review the financial statements of each issuer every year. In Section 408 of the Sarbanes-Oxley Act of 2002, Congress sought to enhance the review of periodic disclosures by requiring the Commission to review each issuer's disclosures no less frequently than once every three years.

Section 14 would further enhance the oversight of larger issuers by requiring the Commission, within one year of the date of enactment of the Act, to conduct a thorough review of the financial statements contained in the most recent periodic disclosures filed with the Commission by the largest 250 reporting issuers, and as many other issuers as the Commission finds appropriate. The Commission also would be required to query these issuers about any unclear statement in their disclosures, and require issuers to respond fully to such queries.

*Section 15. Sense of Congress*

The 2003 Global Research Analyst Settlement established a \$52.5 million Investor Education Fund to develop and support programs designed to equip investors with the knowledge and skills necessary to make informed decisions. Section 15 establishes the sense of Congress that the administrator of the fund should award \$5 million in the form of competitive grants to programs administered by national non-profit educational organizations whose primary purpose is improving the quality of minority and low-income individuals' understanding of personal finance and economics. An additional \$5 million should be awarded in the form of competitive grants to programs administered by national non-profit educational organizations whose primary purpose is improving the quality of elementary and secondary students' understanding of personal finance and economics.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

**SARBANES-OXLEY ACT OF 2002**

**SECTION 1. SHORT TITLE; TABLE OF CONTENTS.**

(a) **SHORT TITLE.**—This Act may be cited as the “Sarbanes-Oxley Act of 2002”.

(b) **TABLE OF CONTENTS.**—The table of contents for this Act is as follows:

Sec. 1. Short title; table of contents.

\* \* \* \* \*

TITLE III—CORPORATE RESPONSIBILITY

Sec. 301. Public company audit committees.

\* \* \* \* \*

Sec. 309. *Recovery of securities law judgments; removal of state law impediments.*

\* \* \* \* \*

TITLE VI—COMMISSION RESOURCES AND AUTHORITY

Sec. 601. Authorization of appropriations.

\* \* \* \* \*

Sec. 605. *Access to grand jury information.*

\* \* \* \* \*

**TITLE III—CORPORATE RESPONSIBILITY**

\* \* \* \* \*

**SEC. 308. FAIR FUNDS FOR INVESTORS.**

**[(a) CIVIL PENALTIES ADDED TO DISGORGEMENT FUNDS FOR THE RELIEF OF VICTIMS.—If in any judicial or administrative action brought by the Commission under the securities laws (as such term is defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)) the Commission obtains an order requiring disgorgement against any person for a violation of such laws or the rules or regulations thereunder, or such person agrees in settlement of any such action to such disgorgement, and the Commission also obtains pursuant to such laws a civil penalty against such person, the amount of such civil penalty shall, on the motion or at the direction of the Commission, be added to and become part of the disgorgement fund for the benefit of the victims of such violation.]**

*(a) CIVIL PENALTIES TO BE USED FOR THE RELIEF OF VICTIMS.—If in any judicial or administrative action brought by the Commission under the securities laws (as such term is defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47))) the Commission obtains pursuant to such laws a civil penalty against any person, such civil penalty monies shall, on the motion or at the direction of the Commission, be added to and become part of a fund for the benefit of the victims of such violation.*

\* \* \* \* \*

*(c) USE OF INVESTOR RESTITUTION FUND BY STATES.—The Commission may allow a State that has received penalty or disgorgement payments pursuant to an agreement or settlement with a broker or dealer or other party in an action concerning securities fraud to contribute those payments to a fund administered by the Commission for the purpose of making restitution payments to investors, whether or not the Commission was a party to the agreement or settlement or had established such fund prior to the State's contribution. The Commission shall have the authority otherwise available to it under the securities laws with respect to the administration and distribution of such funds.*

*(d) UNDISTRIBUTED FUNDS TO BE USED FOR INVESTOR EDUCATION.—In any judicial or administrative action in which a fund*

*is created pursuant to subsection (a) or in which the Commission had obtained disgorgement, if the Commission determines (due to the size of the fund to be distributed, the number of investors, the nature of the underlying violation, or for other reasons) that it would be infeasible to distribute such fund or disgorgement to the victims of the violation, or if after distribution of the fund or disgorgement to victims there are excess monies remaining, the Commission may move for an order in a judicial action, or may issue an order in an administrative proceeding, requiring that the undistributed amount of the fund or disgorgement be used for investor education programs administered by an established not-for-profit or governmental organization whose purposes include investor education and financial literacy.*

\* \* \* \* \*

**[(c)] (e) STUDY REQUIRED.—**  
**(1) SUBJECT OF STUDY.—**The Commission shall review and analyze—  
**(A) \* \* \***

\* \* \* \* \*

**[(d)] (f) CONFORMING AMENDMENTS.—**Each of the following provisions is amended by inserting “, except as otherwise provided in section 308 of the Sarbanes-Oxley Act of 2002” after “Treasury of the United States”:  
**(1) \* \* \***

\* \* \* \* \*

**[(e)] (g) DEFINITION.—**As used in this section, the term “disgorgement fund” means a fund established in any administrative or judicial proceeding described in subsection (a).

**SEC. 309. RECOVERY OF SECURITIES LAW JUDGMENTS; REMOVAL OF STATE LAW IMPEDIMENTS.**

**(a) REMOVAL OF STATE LAW IMPEDIMENTS.—***The Commission’s authority to enforce, collect upon, or otherwise satisfy in a Federal or State court a judgment or order obtained, either by litigation or settlement, in any judicial action or administrative proceeding under the securities laws against any person based upon an alleged fraudulent, deceptive, or manipulative act or practice in violation of such laws, or the rules and regulations thereunder, or against any gratuitous or fraudulent transferee, shall not be subject to—*

*(1) a debtor’s election to exempt property under State or local law pursuant to section 3014(a)(2) of title 28, United States Code; or*

*(2) any homestead provision of any State constitution or any other State law that exempts or protects property from foreclosure, forced sale, or any other procedure to satisfy a judgment or order under any process of court for the payment of debts.*

**(b) DEFINITIONS.—***For purposes of subsection (a)—*

*(1) a “gratuitous transferee” is any person to whom an ownership interest in property is transferred without adequate consideration; and*

*(2) a “fraudulent transferee” is any person liable to the Commission under applicable fraudulent transfer laws.*

\* \* \* \* \*

**TITLE VI—COMMISSION RESOURCES AND AUTHORITY**

\* \* \* \* \*

**SEC. 605. ACCESS TO GRAND JURY INFORMATION.**

*(a) DISCLOSURE OF CERTAIN MATTERS OCCURRING BEFORE GRAND JURY FOR USE IN ENFORCING SECURITIES LAWS.—*

*(1) IN GENERAL.—Upon motion of an attorney for the government, a court may direct disclosure of matters occurring before a grand jury during an investigation of conduct that may constitute a violation of any provision of the securities laws to identified personnel of the Commission for use in relation to any matter within the jurisdiction of the Commission.*

*(2) FINDING OF SUBSTANTIAL NEED REQUIRED.—A court may issue an order under paragraph (1) only upon a finding of a substantial need in the public interest.*

*(b) RESTRICTED USE OF INFORMATION.—A person to whom a matter has been disclosed under this section shall not use such matter other than for the purpose for which such disclosure was authorized.*

*(c) DEFINITIONS.—As used in this section, the terms “attorney for the government” and “grand jury information” have the meanings given to those terms in section 3322 of title 18, United States Code.*

\* \* \* \* \*

**SECURITIES ACT OF 1933**

**TITLE I**

\* \* \* \* \*

**CEASE-AND-DESIST PROCEEDINGS**

**SEC. 8A. (a) \* \* \***

\* \* \* \* \*

**(g) AUTHORITY TO IMPOSE MONEY PENALTIES.—**

*(1) GROUNDS FOR IMPOSING.—In any cease-and-desist proceeding under subsection (a), the Commission may impose a civil penalty on a person if it finds, on the record after notice and opportunity for hearing, that—*

- (A) such person—*
  - (i) is violating or has violated any provision of this title, or any rule or regulation thereunder; or*
  - (ii) is or was a cause of the violation of any provision of this title, or any rule or regulation thereunder; and*
- (B) such penalty is in the public interest.*

*(2) MAXIMUM AMOUNT OF PENALTY.—*

*(A) FIRST TIER.—The maximum amount of penalty for each act or omission described in paragraph (1) shall be \$100,000 for a natural person or \$250,000 for any other person.*

*(B) SECOND TIER.—Notwithstanding paragraph (A), the maximum amount of penalty for each such act or omission*

shall be \$500,000 for a natural person or \$1,000,000 for any other person if the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

(C) *THIRD TIER.*—Notwithstanding paragraphs (A) and (B), the maximum amount of penalty for each such act or omission shall be \$1,000,000 for a natural person or \$2,000,000 for any other person if—

(i) the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and

(ii) such act or omission directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission.

(3) *EVIDENCE CONCERNING ABILITY TO PAY.*—In any proceeding in which the Commission may impose a penalty under this section, a respondent may present evidence of the respondent's ability to pay such penalty. The Commission may, in its discretion, consider such evidence in determining whether such penalty is in the public interest. Such evidence may relate to the extent of such person's ability to continue in business and the collectability of a penalty, taking into account any other claims of the United States or third parties upon such person's assets and the amount of such person's assets.

\* \* \* \* \*

INJUNCTIONS AND PROSECUTION OF OFFENSES

SEC. 20. (a) \* \* \*

\* \* \* \* \*

(d) *MONEY PENALTIES IN CIVIL ACTIONS.*—

(1) \* \* \*

(2) *AMOUNT OF PENALTY.*—

(A) *FIRST TIER.*—The amount of the penalty shall be determined by the court in light of the facts and circumstances. For each violation, the amount of the penalty shall not exceed the greater of (i) **[\$5,000]** \$100,000 for a natural person or **[\$50,000]** \$250,000 for any other person, or (ii) the gross amount of pecuniary gain to such defendant as a result of the violation.

(B) *SECOND TIER.*—Notwithstanding subparagraph (A), the amount of penalty for each such violation shall not exceed the greater of (i) **[\$50,000]** \$500,000 for a natural person or **[\$250,000]** \$1,000,000 for any other person, or (ii) the gross amount of pecuniary gain to such defendant as a result of the violation, if the violation described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

(C) *THIRD TIER.*—Notwithstanding subparagraphs (A) and (B), the amount of penalty for each such violation shall not exceed the greater of (i) **[\$100,000]** \$1,000,000 for a natural person or **[\$500,000]** \$2,000,000 for any

other person, or (ii) the gross amount of pecuniary gain to such defendant as a result of the violation, if—

(I) \* \* \*

\* \* \* \* \*

JURISDICTION OF OFFENSES AND SUITS

SEC. 22. (a) The district courts of the United States and United States courts of any Territory shall have jurisdiction of offenses and violations under this title and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, except as provided in section 16 with respect to covered class actions, of all suits in equity and actions at law brought to enforce any liability or duty created by this title. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. *In any action or proceeding instituted by the Commission under this title in a United States district court for any judicial district, subpoenas issued by or on behalf of such court to compel the attendance of witnesses or the production of documents or tangible things (or both) may be served in any other district. Such subpoenas may be served and enforced without application to the court or a showing of cause, notwithstanding the provisions of rule 45(b)(2), (c)(3)(A)(ii), and (c)(3)(B)(iii) of the Federal Rules of Civil Procedure.* Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, 1292, and 1294 of title 28, United States Code. Except as provided in section 16(c), no case arising under this title and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts.

\* \* \* \* \*

**SECURITIES EXCHANGE ACT OF 1934**

**TITLE I—REGULATION OF SECURITIES EXCHANGES**

\* \* \* \* \*

SECURITIES AND EXCHANGE COMMISSION

SEC. 4. (a) \* \* \*

(b) APPOINTMENT AND COMPENSATION OF STAFF [AND LEASING AUTHORITY.—], LEASING AUTHORITY, AND CONTRACTING AUTHORITY.—

(1) \* \* \*

\* \* \* \* \*

(4) CONTRACTING AUTHORITY.—

(A) IN GENERAL.—*Notwithstanding any other provision of law, the Commission is authorized to enter into contracts to retain private legal counsel to furnish legal services, in-*

*cluding representation in litigation, negotiation, compromise, and settlement, in the case of any claim of indebtedness resulting from any judgment or order (either by litigation or settlement) obtained by the Commission in any judicial action or administrative proceeding brought by or on behalf of the Commission. Private counsel retained under this paragraph may represent the Commission in such debt collection matters to the same extent as the Commission may represent itself.*

*(B) TERMS AND CONDITIONS OF CONTRACT.—Each such contract shall include such terms and conditions as the Commission considers necessary and appropriate, and shall include provisions specifying—*

*(i) the amount of the fee to be paid to the private counsel under such contract or the method for calculating that fee;*

*(ii) that the Commission retains the authority to represent itself, resolve a dispute, compromise a claim, end collection efforts, and refer a matter to other private counsel or to the Attorney General; and*

*(iii) that the Commission may terminate either the contract or the private counsel's representation of the Commission in particular cases for any reason, including for the convenience of the Commission.*

*(C) PAYMENT OF FEES.—Notwithstanding section 3302(b) of title 31, United States Code, a contract under this paragraph may provide that fees and costs incurred by private counsel under such contracts are payable from the amounts recovered.*

*(D) COMPETITION REQUIREMENTS.—Nothing in this paragraph shall relieve the Commission of the competition requirements set forth in title III of the Federal Property and Administrative Services Act of 1949 (41 U.S.C. 251 et seq.).*

*(E) COUNTERCLAIMS.—In any action to recover indebtedness which is brought on behalf of the Commission by private counsel retained under this paragraph, no counterclaim may be asserted against the Commission unless the counterclaim is served directly on the Commission. Such service shall be made in accordance with the rules of procedure of the court in which the action is brought.*

\* \* \* \* \*

REGISTERED SECURITIES ASSOCIATIONS

SEC. 15A. (a) \* \* \*

\* \* \* \* \*

**[(i) A registered securities association shall, within one year from the date of enactment of this section, (1) establish and maintain a toll-free telephone listing to receive inquiries regarding disciplinary actions involving its members and their associated persons, and (2) promptly respond to such inquiries in writing. Such association may charge persons, other than individual investors, reasonable fees for written responses to such inquiries. Such an association shall not have any liability to any person for any actions taken or omitted in good faith under this paragraph.]**

(i) OBLIGATION TO MAINTAIN REGISTRATION, DISCIPLINARY AND OTHER DATA.—

(1) MAINTENANCE OF SYSTEM TO RESPOND TO INQUIRIES.—A registered securities association shall—

(A) establish and maintain a system for collecting and retaining registration information;

(B) establish and maintain a toll-free telephone listing, and a readily accessible electronic or other process, to receive and promptly respond to inquiries regarding—

(i) registration information on its members and their associated persons; and

(ii) registration information on the members and their associated persons of any registered national securities exchange that uses the system described in subparagraph (A) for the registration of its members and their associated persons; and

(C) adopt rules governing the process for making inquiries and the type, scope, and presentation of information to be provided in response to such inquiries in consultation with any registered national securities exchange providing information pursuant to subparagraph (B)(ii).

(2) RECOVERY OF COSTS.—Such an association may charge persons making inquiries, other than individual investors, reasonable fees for responses to such inquiries.

(3) PROCESS FOR DISPUTED INFORMATION.—Such an association shall adopt rules establishing an administrative process for disputing the accuracy of information provided in response to inquiries under this subsection in consultation with any registered national securities exchange providing information pursuant to paragraph (1)(B)(ii).

(4) LIMITATION OF LIABILITY.—Such an association, or exchange reporting information to such an association, shall not have any liability to any person for any actions taken or omitted in good faith under this subsection.

(5) DEFINITION.—For purposes of this subsection, the term “registration information” means the information reported in connection with the registration or licensing of brokers and dealers and their associated persons, including disciplinary actions, regulatory, judicial, and arbitration proceedings, and other information required by law, or exchange or association rule, and the source and status of such information.

\* \* \* \* \*

INVESTIGATIONS; INJUNCTIONS AND PROSECUTION OF OFFENSES

SEC. 21. (a) \* \* \*

\* \* \* \* \*

(d)(1) \* \* \*

\* \* \* \* \*

(3) MONEY PENALTIES IN CIVIL ACTIONS.—

(A) \* \* \*

(B) AMOUNT OF PENALTY.—

(i) FIRST TIER.—The amount of the penalty shall be determined by the court in light of the facts and cir-

cumstances. For each violation, the amount of the penalty shall not exceed the greater of (I) ~~【\$5,000】~~ \$100,000 for a natural person or ~~【\$50,000】~~ \$250,000 for any other person, or (II) the gross amount of pecuniary gain to such defendant as a result of the violation.

(ii) SECOND TIER.—Notwithstanding clause (i), the amount of penalty for each such violation shall not exceed the greater of (I) ~~【\$50,000】~~ \$500,000 for a natural person or ~~【\$250,000】~~ \$1,000,000 for any other person, or (II) the gross amount of pecuniary gain to such defendant as a result of the violation, if the violation described in subparagraph (A) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

(iii) THIRD TIER.—Notwithstanding clauses (i) and (ii), the amount of penalty for each such violation shall not exceed the greater of (I) ~~【\$100,000】~~ \$1,000,000 for a natural person or ~~【\$500,000】~~ \$2,000,000 for any other person, or (II) the gross amount of pecuniary gain to such defendant as a result of the violation, if—

(aa) \* \* \*

\* \* \* \* \*

(h)(1) \* \* \*

【(2) Notwithstanding section 1105 or 1107 of the Right to Financial Privacy Act of 1978, the Commission may have access to and obtain copies of, or the information contained in financial records of a customer from a financial institution without prior notice to the customer upon an ex parte showing to an appropriate United States district court that the Commission seeks such financial records pursuant to a subpoena issued in conformity with the requirements of section 19(b) of the Securities Act of 1933, section 21(b) of the Securities Exchange Act of 1934, section 18(c) of the Public Utility Holding Company Act of 1935, section 42(b) of the Investment Company Act of 1940, or section 209(b) of the Investment Advisers Act of 1940, and that the Commission has reason to believe that—

【(A) delay in obtaining access to such financial records, or the required notice, will result in—

【(i) flight from prosecution;

【(ii) destruction of or tampering with evidence;

【(iii) transfer of assets or records outside the territorial limits of the United States;

【(iv) improper conversion of investor assets; or

【(v) impeding the ability of the Commission to identify or trace the source or disposition of funds involved in any securities transaction;

【(B) such financial records are necessary to identify or trace the record or beneficial ownership interest in any security;

【(C) the acts, practices or course of conduct under investigation involve—

【(i) the dissemination of materially false or misleading information concerning any security, issuer, or market, or the failure to make disclosures required under the securities laws, which remain uncorrected; or

- [(ii) a financial loss to investors or other persons protected under the securities laws which remains substantially uncompensated; or
- [(D) the acts, practices or course of conduct under investigation—
- [(i) involve significant financial speculation in securities;
- or
- [(ii) endanger the stability of any financial or investment intermediary.

[(3) Any application under paragraph (2) for a delay in notice shall be made with reasonable specificity.

[(4)(A) Upon a showing described in paragraph (2), the presiding judge or magistrate shall enter an ex parte order granting the requested delay for a period not to exceed ninety days and an order prohibiting the financial institution involved from disclosing that records have been obtained or that a request for records has been made.

[(B) Extensions of the period of delay of notice provided in subparagraph (A) of up to ninety days each may be granted by the court upon application, but only in accordance with this subsection or section 1109(a), (b)(1), or (b)(2) of the Right to Financial Privacy Act of 1978.

[(C) Upon expiration of the period of delay of notification ordered under subparagraph (A) or (B), the customer shall be served with or mailed a copy of the subpoena insofar as it applies to the customer together with the following notice which shall describe with reasonable specificity the nature of the investigation for which the Commission sought the financial records:

["Records or information concerning your transactions which are held by the financial institution named in the attached subpoena were supplied to the Securities and Exchange Commission on (date). Notification was withheld pursuant to a determination by the (title of court so ordering) under section 21(h) of the Securities Exchange Act of 1934 that (state reason). The purpose of the investigation or official proceeding was (state purpose)."]

[(5) Upon application by the Commission, all proceedings pursuant to paragraphs (2) and (4) shall be held in camera and the records thereof sealed until expiration of the period of delay or such other date as the presiding judge or magistrate may permit.

[(6) The Commission shall compile an annual tabulation of the occasions on which the Commission used each separate subparagraph or clause of paragraph (2) of this subsection or the provisions of the Right to Financial Privacy Act of 1978 to obtain access to financial records of a customer and include it in its annual report to the Congress. Section 1121(b) of the Right to Financial Privacy Act of 1978 shall not apply with respect to the Commission.

[(7)(A) Following the expiration of the period of delay of notification ordered by the court pursuant to paragraph (4) of this subsection, the customer may, upon motion, reopen the proceeding in the district court which issued the order. If the presiding judge or magistrate finds that the movant is the customer to whom the records obtained by the Commission pertain, and that the Commission has obtained financial records or information contained therein in violation of this subsection, other than paragraph (1), it may

order that the customer be granted civil penalties against the Commission in an amount equal to the sum of—

- [(i) \$100 without regard to the volume of records involved;
- [(ii) any out-of-pocket damages sustained by the customer as a direct result of the disclosure; and
- [(iii) if the violation is found to have been willful, intentional, and without good faith, such punitive damages as the court may allow, together with the costs of the action and reasonable attorney's fees as determined by the court.

[(B) Upon a finding that the Commission has obtained financial records or information contained therein in violation of this subsection, other than paragraph (1), the court, in its discretion, may also or in the alternative issue injunctive relief to require the Commission to comply with this subsection with respect to any subpoena which the Commission issues in the future for financial records of such customer for purposes of the same investigation.

[(C) Whenever the court determines that the Commission has failed to comply with this subsection, other than paragraph (1), and the court finds that the circumstances raise questions of whether an officer or employee of the Commission acted in a willful and intentional manner and without good faith with respect to the violation, the Office of Personnel Management shall promptly initiate a proceeding to determine whether disciplinary action is warranted against the agent or employee who was primarily responsible for the violation. After investigating and considering the evidence submitted, the Office of Personnel Management shall submit its findings and recommendations to the Commission and shall send copies of the findings and recommendations to the officer or employee or his representative. The Commission shall take the corrective action that the Office of Personnel Management recommends.

[(8) The relief described in paragraphs (7) and (10) shall be the only remedies or sanctions available to a customer for a violation of this subsection, other than paragraph (1), and nothing herein or in the Right to Financial Privacy Act of 1978 shall be deemed to prohibit the use in any investigation or proceeding of financial records, or the information contained therein, obtained by a subpoena issued by the Commission. In the case of an unsuccessful action under paragraph (7), the court shall award the costs of the action and attorney's fees to the Commission if the presiding judge or magistrate finds that the customer's claims were made in bad faith.]

(2) ACCESS TO FINANCIAL RECORDS.—

(A) IN GENERAL.—Notwithstanding section 1105 or 1107 of the Right to Financial Privacy Act of 1978, the Commission may obtain access to and copies of, or the information contained in, financial records of any person held by a financial institution, including the financial records of a customer, without notice to that person, when it acts pursuant to a subpoena authorized by a formal order of investigation of the Commission and issued under the securities laws or pursuant to an administrative or judicial subpoena issued in a proceeding or action to enforce the securities laws.

(B) NONDISCLOSURE OF REQUESTS.—If the Commission so directs in its subpoena, no financial institution, or officer, director, partner, employee, shareholder, representative

or agent of such financial institution, shall, directly or indirectly, disclose that records have been requested or provided in accordance with subparagraph (A), if the Commission finds reason to believe that such disclosure may—

(i) result in the transfer of assets or records outside the territorial limits of the United States;

(ii) result in improper conversion of investor assets;

(iii) impede the ability of the Commission to identify, trace, or freeze funds involved in any securities transaction;

(iv) endanger the life or physical safety of an individual;

(v) result in flight from prosecution;

(vi) result in destruction of or tampering with evidence;

(vii) result in intimidation of potential witnesses; or

(viii) otherwise seriously jeopardize an investigation or unduly delay a trial.

(C) *TRANSFER OF RECORDS TO GOVERNMENT AUTHORITIES.*—The Commission may transfer financial records or the information contained therein to any government authority, if the Commission proceeds as a transferring agency in accordance with section 1112 of the Right to Financial Privacy Act of 1978 (12 U.S.C. 3412), except that a customer notice shall not be required under subsection (b) or (c) of that section 1112, if the Commission determines that there is reason to believe that such notification may result in or lead to any of the factors identified under clauses (i) through (viii) of subparagraph (B) of this paragraph.

[(9)(A) The Commission may transfer financial records or the information contained therein to any government authority if the Commission proceeds as a transferring agency in accordance with section 1112 of the Right to Financial Privacy Act of 1978, except that the customer notice required under section 1112(b) or (c) of such Act may be delayed upon a showing by the Commission, in accordance with the procedure set forth in paragraphs (4) and (5), that one or more of subparagraphs (A) through (D) of paragraph (2) apply.

[(B) The] (3) *The Commission may, without notice to the customer pursuant to section 1112 of the Right to Financial Privacy Act of 1978, transfer financial records or the information contained therein to a State securities agency or to the Department of Justice. Financial records or information transferred by the Commission to the Department of Justice or to a State securities agency pursuant to the provisions of this subparagraph may be disclosed or used only in an administrative, civil, or criminal action or investigation by the Department of Justice or the State securities agency which arises out of or relates to the acts, practices, or courses of conduct investigated by the Commission, except that if the Department of Justice or the State securities agency determines that the information should be disclosed or used for any other purpose, it may do so if it notifies the customer, except as otherwise provided in the Right to Financial Privacy Act of 1978, within 30 days of its determination, or complies with the requirements of section 1109 of such Act regarding delay of notice.*

[(10) Any government authority violating paragraph (9) shall be subject to the procedures and penalties applicable to the Commission under paragraph (7)(A) with respect to a violation by the Commission in obtaining financial records.]

[(11)] (4) Notwithstanding the provisions of this subsection, the Commission may obtain financial records from a financial institution or transfer such records in accordance with provisions of the Right to Financial Privacy Act of 1978.

[(12)] (5) Nothing in this subsection shall enlarge or restrict any rights of a financial institution to challenge requests for records made by the Commission under existing law. Nothing in this subsection shall entitle a customer to assert any rights of a financial institution.

[(13)] (6) Unless the context otherwise requires, all terms defined in the Right to Financial Privacy Act of 1978 which are common to this subsection shall have the same meaning as in such Act.

\* \* \* \* \*

CIVIL PENALTIES FOR INSIDER TRADING

SEC. 21A. (a) AUTHORITY TO IMPOSE CIVIL PENALTIES.—

(1) \* \* \*

\* \* \* \* \*

(3) AMOUNT OF PENALTY FOR CONTROLLING PERSON.—The amount of the penalty which may be imposed on any person who, at the time of the violation, directly or indirectly controlled the person who committed such violation, shall be determined by the court in light of the facts and circumstances, but shall not exceed the greater of [ \$1,000,000 ] \$2,000,000, or three times the amount of the profit gained or loss avoided as a result of such controlled person's violation. If such controlled person's violation was a violation by communication, the profit gained or loss avoided as a result of the violation shall, for purposes of this paragraph only, be deemed to be limited to the profit gained or loss avoided by the person or persons to whom the controlled person directed such communication.

\* \* \* \* \*

CIVIL REMEDIES IN ADMINISTRATIVE PROCEEDINGS

SEC. 21B. [(a) COMMISSION AUTHORITY TO ASSESS MONEY PENALTIES.—In any proceeding]

(a) COMMISSION AUTHORITY TO ASSESS MONEY PENALTIES.—

(1) IN GENERAL.—In any proceeding instituted pursuant to sections 15(b)(4), 15(b)(6), 15D, 15B, 15C, or 17A of this title against any person, the Commission or the appropriate regulatory agency may impose a civil penalty if it finds, on the record after notice and opportunity for hearing, that such person—

[(1)] (A) has willfully violated any provision of the Securities Act of 1933, the Investment Company Act of 1940, the Investment Advisers Act of 1940, or this title, or the rules or regulations thereunder, or the rules of the Municipal Securities Rulemaking Board;

[(2)] (B) has willfully aided, abetted, counseled, commanded, induced, or procured such a violation by any other person;

[(3)] (C) has willfully made or caused to be made in any application for registration or report required to be filed with the Commission or with any other appropriate regulatory agency under this title, or in any proceeding before the Commission with respect to registration, any statement which was, at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, or has omitted to state in any such application or report any material fact which is required to be stated therein; or

[(4)] (D) has failed reasonably to supervise, within the meaning of section 15(b)(4)(E) of this title, with a view to preventing violations of the provisions of such statutes, rules and regulations, another person who commits such a violation, if such other person is subject to his supervision; and that such penalty is in the public interest.

(2) CEASE-AND-DESIST PROCEEDINGS.—In any proceeding instituted pursuant to section 21C of this title against any person, the Commission may impose a civil penalty if it finds, on the record after notice and opportunity for hearing, that such person—

(A) is violating or has violated any provision of this title, or any rule or regulation thereunder; or

(B) is or was a cause of the violation of any provision of this title, or any rule or regulation thereunder.

(b) MAXIMUM AMOUNT OF PENALTY.—

(1) FIRST TIER.—The maximum amount of penalty for each act or omission described in subsection (a) shall be [\$5,000] \$100,000 for a natural person or [\$50,000] \$250,000 for any other person.

(2) SECOND TIER.—Notwithstanding paragraph (1), the maximum amount of penalty for each such act or omission shall be [\$50,000] \$500,000 for a natural person or [\$250,000] \$1,000,000 for any other person if the act or omission described in subsection (a) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

(3) THIRD TIER.—Notwithstanding paragraphs (1) and (2), the maximum amount of penalty for each such act or omission shall be [\$100,000] \$1,000,000 for a natural person or [\$500,000] \$2,000,000 for any other person if—

(A) \* \* \*

\* \* \* \* \*

PUBLIC AVAILABILITY OF INFORMATION

SEC. 24. (a) \* \* \*

\* \* \* \* \*

(e) AUTHORITY TO ACCEPT PRIVILEGED AND PROTECTED INFORMATION.—

(1) AUTHORITY.—Notwithstanding any other provision of law, whenever the Commission or an appropriate regulatory agency and any person agree in writing to terms pursuant to which

*such person will produce or disclose to the Commission or the appropriate regulatory agency any document or information that is subject to any Federal or State law privilege, or to the protection provided by the work product doctrine, such production or disclosure shall not constitute a waiver of the privilege or protection as to any person other than the Commission or the appropriate regulatory agency to which the document or information is provided.*

(2) DEFINITION.—For purposes of this subsection, the term “appropriate regulatory agency” means the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, or the Board of Governors of the Federal Reserve System.

[(e)] (f) SAVINGS PROVISIONS.—Nothing in this section shall—

(1) \* \* \*

\* \* \* \* \*

JURISDICTION OF OFFENSES AND SUITS

SEC. 27. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. *In any action or proceeding instituted by the Commission under this title in a United States district court for any judicial district, subpoenas issued by or on behalf of such court to compel the attendance of witnesses or the production of documents or tangible things (or both) may be served in any other district. Such subpoenas may be served and enforced without application to the court or a showing of cause, notwithstanding the provisions of rule 45(b)(2), (c)(3)(A)(ii), and (c)(3)(B)(iii) of the Federal Rules of Civil Procedure.* Any suit or action to enforce any liability or duty created by this title or rules and regulations thereunder, or to enjoin any violation of such title or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, 1292, and 1294 of title 28, United States Code. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts.

\* \* \* \* \*

PENALTIES

SEC. 32. (a) \* \* \*

(b) Any issuer which fails to file information, documents, or reports required to be filed under subsection (d) of section 15 of this title or any rule or regulation thereunder shall forfeit to the United States the sum of **[\$100]** \$10,000 for each and every day such fail-

ure to file shall continue. Such forfeiture, which shall be in lieu of any criminal penalty for such failure to file which might be deemed to arise under subsection (a) of this section, shall be payable into the Treasury of the United States and shall be recoverable in a civil suit in the name of the United States.

(c)(1)(A) \* \* \*

(B) Any issuer that violates subsection (a) or (g) of section 30A shall be subject to a civil penalty of not more than **[\$10,000]** \$500,000 imposed in an action brought by the Commission.

(2)(A) \* \* \*

(B) Any officer, director, employee, or agent of an issuer, or stockholder acting on behalf of such issuer, who violates subsection (a) or (g) of section 30A of this title shall be subject to a civil penalty of not more than **[\$10,000]** \$500,000 imposed in an action brought by the Commission.

\* \* \* \* \*

**INVESTMENT COMPANY ACT OF 1940**

**TITLE I—INVESTMENT COMPANIES**

\* \* \* \* \*

**INELIGIBILITY OF CERTAIN AFFILIATED PERSONS AND UNDERWRITERS**

**SEC. 9. (a) \* \* \***

\* \* \* \* \*

**(d) MONEY PENALTIES IN ADMINISTRATIVE PROCEEDINGS.—**

**[(1) AUTHORITY OF COMMISSION.—In any proceeding]**

**(1) AUTHORITY OF COMMISSION.—**

**(A) IN GENERAL.—***In any proceeding* instituted pursuant to subsection (b) against any person, the Commission may impose a civil penalty if it finds, on the record after notice and opportunity for hearing, that such person—

**[(A)]** *(i)* has willfully violated any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, or this title, or the rules or regulations thereunder;

**[(B)]** *(ii)* has willfully aided, abetted, counseled, commanded, induced, or procured such a violation by any other person; or

**[(C)]** *(iii)* has willfully made or caused to be made in any registration statement, application, or report required to be filed with the Commission under this title, any statement which was, at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, or has omitted to state in any such registration statement, application, or report any material fact which was required to be stated therein;

and that such penalty is in the public interest.

**(B) CEASE-AND-DESIST PROCEEDINGS.—***In any proceeding* instituted pursuant to subsection (f) against any person, the Commission may impose a civil penalty if it finds, on the

record after notice and opportunity for hearing, that such person—

(i) is violating or has violated any provision of this title, or any rule or regulation thereunder; or

(ii) is or was a cause of the violation of any provision of this title, or any rule or regulation thereunder.

(2) MAXIMUM AMOUNT OF PENALTY.—

(A) FIRST TIER.—The maximum amount of penalty for each act or omission described in paragraph (1) shall be ~~[\$5,000]~~ \$100,000 for a natural person or ~~[\$50,000]~~ \$250,000 for any other person.

(B) SECOND TIER.—Notwithstanding subparagraph (A), the maximum amount of penalty for each such act or omission shall be ~~[\$50,000]~~ \$500,000 for a natural person or ~~[\$250,000]~~ \$1,000,000 for any other person if the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

(C) THIRD TIER.—Notwithstanding subparagraphs (A) and (B), the maximum amount of penalty for each such act or omission shall be ~~[\$100,000]~~ \$1,000,000 for a natural person or ~~[\$500,000]~~ \$2,000,000 for any other person if—

(i) \* \* \*

\* \* \* \* \*

AFFILIATIONS OF DIRECTORS

SEC. 10. (a)(1) No registered investment company shall have a board of directors more than 60 per centum of the members of which are persons who are interested persons of such registered company.

(2) The board of directors of such a company shall select a lead independent director who is not an interested person and who shall (A) have authority to place items on the agenda for consideration, call meetings, and obtain outside advice on behalf of the independent directors, and (B) have such other authority as the Commission determines by rule to be necessary or useful. This paragraph shall not apply if the chairman of the board is an independent director.

\* \* \* \* \*

INVESTMENT ADVISORY AND UNDERWRITING CONTRACTS

SEC. 15. (a) \* \* \*

\* \* \* \* \*

[(c) In addition to the requirements of subsections (a) and (b) of this section, it shall be unlawful for any registered investment company having a board of directors to enter into, renew, or perform any contract or agreement, written or oral, whereby a person undertakes regularly to serve or act as investment adviser of or principal underwriter for such company, unless the terms of such contract or agreement and any renewal thereof have been approved by the vote of a majority of directors, who are not parties to such contract or agreement or interested persons of any such party, cast in person at a meeting called for the purpose of voting on such ap-

proval. It shall be the duty of the directors of a registered investment company to request and evaluate, and the duty of an investment adviser to such company to furnish, such information as may reasonably be necessary to evaluate the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser of such company. It shall be unlawful for the directors of a registered investment company, in connection with their evaluation of the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser of such company, to take into account the purchase price or other consideration any person may have paid in connection with a transaction of the type referred to in paragraph (1), (3), or (4) of subsection (f).]

*(c) PROCESS FOR CONTRACT RENEWAL.—*

*(1) APPROVAL BY MAJORITY OF INDEPENDENT DIRECTORS.—In addition to the requirements of subsections (a) and (b) of this section, it shall be unlawful for any registered investment company having a board of directors to enter into, renew, or perform any contract or agreement, written or oral, whereby a person undertakes regularly to serve or act as investment adviser of or principal underwriter for such company, unless the terms of such contract or agreement and any renewal thereof have been approved by the vote of a majority of directors, who are not parties to such contract or agreement or interested persons of any such party, cast in person at a meeting called for the purpose of voting on such approval.*

*(2) INFORMATION DISCLOSURES AND EVALUATIONS.—*

*(A) IN GENERAL.—It shall be the duty of the directors of a registered investment company to request and evaluate, and the duty of an investment adviser or principal underwriter of such company to furnish, such information as may reasonably be necessary to evaluate the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser or principal underwriter of such company.*

*(B) INVESTMENT ADVISER DUTY.—In addition to the investment adviser's duty under subparagraph (A), when entering into or renewing a contract or agreement, it shall be the duty of the investment adviser—*

*(i) to provide the independent directors of a registered investment company with all material information about any of its business practices, or the business practices of any of its affiliated persons, that may conflict with the best interests of the shareholders of the registered investment company; and*

*(ii) to specify and commit to implement procedures that are reasonably designed to ensure services are provided in the best interests of such shareholders.*

*(C) PRINCIPAL UNDERWRITER DUTY.—In addition to the principal underwriter's duty under subparagraph (A), when entering into or renewing a contract or agreement, it shall be the duty of the principal underwriter—*

*(i) to provide the independent directors of a registered investment company with all material information about any of its business practice that may conflict*

*with the best interests of the shareholders of the registered investment company; and*

*(ii) to specify and commit to implement procedures that are reasonably designed to ensure services are provided in the best interests of such shareholders.*

*(D) INDEPENDENT DIRECTORS DUTY.—In addition to the independent directors' duty under subparagraph (A), it shall be the duty of the independent directors to determine whether the specified procedures of the investment adviser and the principal underwriter offer a reasonable likelihood of protecting the best interests of the shareholders of the registered investment company.*

*(3) LIMITATION ON CONSIDERATIONS.—It shall be unlawful for the directors of a registered investment company, in connection with their evaluation of the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser of such company, to take into account the purchase price or other consideration any person may have paid in connection with a transaction of the type referred to in paragraph (1), (3), or (4) of subsection (f).*

\* \* \* \* \*

ENFORCEMENT OF TITLE

SEC. 42. (a) \* \* \*

\* \* \* \* \*

(e) MONEY PENALTIES IN CIVIL ACTIONS.—

(1) \* \* \*

(2) AMOUNT OF PENALTY.—

(A) FIRST TIER.—The amount of the penalty shall be determined by the court in light of the facts and circumstances. For each violation, the amount of the penalty shall not exceed the greater of (i) ~~[\$5,000]~~ \$100,000 for a natural person or ~~[\$50,000]~~ \$250,000 for any other person, or (ii) the gross amount of pecuniary gain to such defendant as a result of the violation.

(B) SECOND TIER.—Notwithstanding subparagraph (A), the amount of penalty for each such violation shall not exceed the greater of (i) ~~[\$50,000]~~ \$500,000 for a natural person or ~~[\$250,000]~~ \$1,000,000 for any other person, or (ii) the gross amount of pecuniary gain to such defendant as a result of the violation, if the violation described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

(C) THIRD TIER.—Notwithstanding subparagraphs (A) and (B), the amount of penalty for each such violation shall not exceed the greater of (i) ~~[\$100,000]~~ \$1,000,000 for a natural person or ~~[\$500,000]~~ \$2,000,000 for any other person, or (ii) the gross amount of pecuniary gain to such defendant as a result of the violation, if—

(I) \* \* \*

\* \* \* \* \*

JURISDICTION OF OFFENSES AND SUITS

SEC. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. A criminal proceeding based upon a violation of section 34, or upon a failure to file a report or other document required to be filed under this title, may be brought in the district wherein the defendant is an inhabitant or maintains his principal office or place of business. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. *In any action or proceeding instituted by the Commission under this title in a United States district court for any judicial district, subpoenas issued by or on behalf of such court to compel the attendance of witnesses or the production of documents or tangible things (or both) may be served in any other district. Such subpoenas may be served and enforced without application to the court or a showing of cause, notwithstanding the provisions of rule 45(b)(2), (c)(3)(A)(ii), and (c)(3)(B)(iii) of the Federal Rules of Civil Procedure.* Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, 1292, and 1294 of title 28, United States Code. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against the Commission in any court. The Commission may intervene as a party in any action or suit to enforce any liability or duty created by, or to enjoin any noncompliance with, section 36(b) of this title at any stage of such action or suit prior to final judgment therein.

\* \* \* \* \*

**INVESTMENT ADVISERS ACT OF 1940**

TITLE II—INVESTMENT ADVISERS

\* \* \* \* \*

REGISTRATION OF INVESTMENT ADVISERS

SEC. 203. (a) \* \* \*

\* \* \* \* \*

(i) MONEY PENALTIES IN ADMINISTRATIVE PROCEEDINGS.—

**[(1) AUTHORITY OF COMMISSION.—In any proceeding]**

*(1) AUTHORITY OF COMMISSION.—*

*(A) IN GENERAL.—In any proceeding instituted pursuant to subsection (e) or (f) against any person, the Commission*

may impose a civil penalty if it finds, on the record after notice and opportunity for hearing, that such person—

[(A)] *(i)* has willfully violated any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, or this title, or the rules or regulations thereunder;

[(B)] *(ii)* has willfully aided, abetted, counseled, commanded, induced, or procured such a violation by any other person;

[(C)] *(iii)* has willfully made or caused to be made in any application for registration or report required to be filed with the Commission under this title, or in any proceeding before the Commission with respect to registration, any statement which was, at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, or has omitted to state in any such application or report any material fact which was required to be stated therein; or

[(D)] *(iv)* has failed reasonably to supervise, within the meaning of subsection (e)(6), with a view to preventing violations of the provisions of this title and the rules and regulations thereunder, another person who commits such a violation, if such other person is subject to his supervision;

and that such penalty is in the public interest.

*(B) CEASE-AND-DESIST PROCEEDINGS.—In any proceeding instituted pursuant to subsection (k) against any person, the Commission may impose a civil penalty if it finds, on the record after notice and opportunity for hearing, that such person—*

*(i) is violating or has violated any provision of this title, or any rule or regulation thereunder; or*

*(ii) is or was a cause of the violation of any provision of this title, or any rule or regulation thereunder.*

(2) MAXIMUM AMOUNT OF PENALTY.—

(A) FIRST TIER.—The maximum amount of penalty for each act or omission described in paragraph (1) shall be ~~[\$5,000]~~ \$100,000 for a natural person or ~~[\$50,000]~~ \$250,000 for any other person.

(B) SECOND TIER.—Notwithstanding subparagraph (A), the maximum amount of penalty for each such act or omission shall be ~~[\$50,000]~~ \$500,000 for a natural person or ~~[\$250,000]~~ \$1,000,000 for any other person if the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

(C) THIRD TIER.—Notwithstanding subparagraphs (A) and (B), the maximum amount of penalty for each such act or omission shall be ~~[\$100,000]~~ \$1,000,000 for a natural person or ~~[\$500,000]~~ \$2,000,000 for any other person if—

(i) \* \* \*

**SEC. 203A. STATE AND FEDERAL RESPONSIBILITIES.**

(a) \* \* \*

\* \* \* \* \*

[(d) FILING DEPOSITORIES.—The Commission may, by rule, require an investment adviser—

[(1) to file with the Commission any fee, application, report, or notice required by this title or by the rules issued under this title through any entity designated by the Commission for that purpose; and

[(2) to pay the reasonable costs associated with such filing.]

[(e)] (d) STATE ASSISTANCE.—Upon request of the securities commissioner (or any agency or officer performing like functions) of any State, the Commission may provide such training, technical assistance, or other reasonable assistance in connection with the regulation of investment advisers by the State.

## ANNUAL AND OTHER REPORTS

SEC. 204. [Every investment] (a) *IN GENERAL.*—Every investment adviser who makes use of the mails or of any means or instrumentality of interstate commerce in connection with his or its business as an investment adviser (other than one specifically exempted from registration pursuant to section 203(b) of this title), shall make and keep for prescribed periods such records (as defined in section 3(a)(37) of the Securities Exchange Act of 1934), furnish such copies thereof, and make and disseminate such reports as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors. All records (as so defined) of such investment advisers are subject at any time, or from time to time, to such reasonable periodic, special, or other examinations by representatives of the Commission as the Commission deems necessary or appropriate in the public interest or for the protection of investors.

(b) *FILING DEPOSITORIES.*—The Commission may, by rule, require an investment adviser—

(1) to file with the Commission any fee, application, report, or notice required to be filed by this title or the rules issued under this title through any entity designated by the Commission for that purpose; and

(2) to pay the reasonable costs associated with such filing and the establishment and maintenance of the systems required by subsection (c).

(c) *ACCESS TO DISCIPLINARY AND OTHER INFORMATION.*—

(1) *MAINTENANCE OF SYSTEM TO RESPOND TO INQUIRIES.*—The Commission shall require the entity designated by the Commission under subsection (b)(1) to establish and maintain a toll-free telephone listing, and a readily accessible electronic or other process, to receive and promptly respond to inquiries regarding registration information (including disciplinary actions, regulatory, judicial, and arbitration proceedings, and other information required by law or rule to be reported) involving investment advisers and persons associated with investment advisers.

(2) *RECOVERY OF COSTS.*—An entity designated by the Commission under subsection (b)(1) may charge persons making in-

*quiries, other than individual investors, reasonable fees for responses to inquiries made under paragraph (1).*

*(3) LIMITATION ON LIABILITY.—An entity designated by the Commission under subsection (b)(1) shall not have any liability to any person for any actions taken or omitted in good faith under this subsection.*

\* \* \* \* \*

ENFORCEMENT OF TITLE

SEC. 209. (a) \* \* \*

\* \* \* \* \*

(e) MONEY PENALTIES IN CIVIL ACTIONS.—

(1) \* \* \*

(2) AMOUNT OF PENALTY.—

(A) FIRST TIER.—The amount of the penalty shall be determined by the court in light of the facts and circumstances. For each violation, the amount of the penalty shall not exceed the greater of (i) ~~[\$5,000]~~ \$100,000 for a natural person or ~~[\$50,000]~~ \$250,000 for any other person, or (ii) the gross amount of pecuniary gain to such defendant as a result of the violation.

(B) SECOND TIER.—Notwithstanding subparagraph (A), the amount of penalty for each such violation shall not exceed the greater of (i) ~~[\$50,000]~~ \$500,000 for a natural person or ~~[\$250,000]~~ \$1,000,000 for any other person, or (ii) the gross amount of pecuniary gain to such defendant as a result of the violation, if the violation described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

(C) THIRD TIER.—Notwithstanding subparagraphs (A) and (B), the amount of penalty for each such violation shall not exceed the greater of (i) ~~[\$100,000]~~ \$1,000,000 for a natural person or ~~[\$500,000]~~ \$2,000,000 for any other person, or (ii) the gross amount of pecuniary gain to such defendant as a result of the violation, if—

(I) \* \* \*

\* \* \* \* \*

JURISDICTION OF OFFENSES AND SUITS

SEC. 214. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of

which the defendant is an inhabitant or transacts business or wherever the defendant may be found. *In any action or proceeding instituted by the Commission under this title in a United States district court for any judicial district, subpoenas issued by or on behalf of such court to compel the attendance of witnesses or the production of documents or tangible things (or both) may be served in any other district. Such subpoenas may be served and enforced without application to the court or a showing of cause, notwithstanding the provisions of rule 45(b)(2), (c)(3)(A)(ii), and (c)(3)(B)(iii) of the Federal Rules of Civil Procedure.* Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, 1292, and 1294 of title 28, United States Code. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against the Commission in any court.

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**NATIONAL SECURITIES MARKETS IMPROVEMENT ACT  
OF 1996**

\* \* \* \* \*

**TITLE III—INVESTMENT ADVISERS  
SUPERVISION COORDINATION ACT**

\* \* \* \* \*

**[SEC. 306. INVESTOR ACCESS TO INFORMATION.**

**[The Commission shall—**

**[(1) provide for the establishment and maintenance of a readily accessible telephonic or other electronic process to receive inquiries regarding disciplinary actions and proceedings involving investment advisers and persons associated with investment advisers; and**

**[(2) provide for prompt response to any inquiry described in paragraph (1).]**

\* \* \* \* \*

## DISSENTING VIEWS

The Committee on Financial Services should reject H.R. 2179, the Securities Fraud Deterrence and Investor Restitution Act, because it tramples States' rights and exceeds Congress' constitutional authority by voiding State homestead laws. Homestead laws protect certain property from being taken from a property owner to settle that owner's debts. While one may legitimately be concerned about perpetrators of fraud misusing homestead laws, it is not the role of Congress to determine when homestead exemptions do, and do not, apply.

Supporters of H.R. 2179 claim that voiding State homestead exemptions will increase the deterrent value of Securities and Exchange Commission (SEC) actions. However this claim assumes that it is proper for the federal government to prosecute fraud. In fact, prosecuting fraud is the responsibility of State and local governments. The Constitution only authorizes the Federal government to prosecute the crimes of treason, piracy, and counterfeiting. Authority over all other criminal matters is reserved to the States. Therefore, expanding Federal jurisdiction to cover securities fraud is a violation of the government's Constitutional limits. Congress should not use its usurpation of the States' authority to prosecute crimes of fraud as a justification for usurping the States' authority to pass laws providing homestead exemptions.

In conclusion, Mr. Chairman, since H.R. 2179 intrudes on the State's Constitutionally protected authority to pass homestead exemption laws, I urge the Committee on Financial Services to reject this misguided, unconstitutional, bill.

RON PAUL.

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